ACCEPTANCE BY THE VIVA VOCE COMMITTEE

Title of Thesis

APPLICATION OF ISLAMIC FINANCING MODES TO AGRICULTURAL SECTOR IN PAKISTAN: AN ANALYSIS OF *SHARĪʻAH* AND REGULATORY ISSUES

Submitted by:Lutfullah

REG # 10-FSL/PHD/F10

1. **Prof.Dr. Muhammad Tahir Mansoori**

Supervisor

2. **Dr. Abdull ah Rizk Al Muzaine**

Internal Examiner

3. **Dr. Hafiz Muhammad Yasin**

External Examiner

4. **Dr. Muhammad M ti ur Rehman**

APPLICATION OF ISLAMIC FINANCING MODES TO AGRICULTURAL SECTOR IN PAKISTAN: AN ANALYSIS OF *SHARĪ'AH* AND REGULATORY ISSUES

Researcher: Supervisor:

Lutfullah **Dr. Muhammad Tahir Mansoori**

REG # 10-FSL/PHD/F10

Faculty of Sharī'ah and Law

INTERNATIONAL ISLAMIC UNIVERSITY

ISLAMABAD

APPLICATION OF ISLAMIC FINANCING MODES TO AGRICULTURAL SECTOR IN PAKISTAN: AN ANALYSIS OF *SHARĪ‘AH* AND REGULATORY ISSUES

Lutfullah

REG # 10-FSL/PHD/F10

A thesis submitted in partial fulfillment of the requirements for the Degree of Doctor of Philosophy in Sharī‘ah at the Faculty of Sharī‘ah& Law
International Islamic University,
Islamabad

Supervisor

Dr. Tahir Mansoori

January, 2015



In the name of Allah, the most merciful and beneficent

DECLARATION

I hereby declare that this thesis, neither as a whole nor as a part thereof, has been copied out from any source. It is further declared that I have prepared this thesis entirely on the basis of my personal effort, made under the sincere guidance of my supervisor and colleagues. No portion of work, presented in this thesis has been submitted in support of any application for any degree or qualification of this or any other university or institute of learning.

Lutfullah

PhD Candidate (Shariah and Law)

Faculty of Shariah and Law

DEDICATION

"To my beloved parents who are praise worthy for their sustenance of me on right lines because I am today, only due to their untiring efforts for my sake"

APPRECIATION AND GRATITUDE

All the praises are attributed to the sole creator of the universe “the Almighty Allah, the Compassionate, the Merciful, the Source of all knowledge and wisdom, who granted me health, thought, talented, sincere and cooperative teachers, friendly brothers and sisters, helping friends and power of communication and who gave me the strong courage to complete this thesis. I express my deepest and sincere gratitude to my honorable and grandeur supervisor Dr.Tahir Mansoori (Professor, Faculty of Shariah and Law) for his inspiring guidance and continuous encouragement during the completion of this project .I also express my deepest gratitude to my teachers, colleagues, friends, and family members for their support and guidance.

Lutfullah

ABSTRACT

ABSTRACT

Food is one of the basic necessities that is imperative for the nourishment and survival of human life. Agriculture is probably the most important source through which farmers augment food supply for themselves and others to meet the current and future demands. Majority of these farmers belong to the lower class and hence not in position to fulfill their agricultural wants both for crop and non crop activities. They borrow it, therefore, from various sources on interest basis including organizations, banks, and government. Such sources are existing in the country (Pakistan) since its independence and playing their role in the development of agriculture sector, both in crop and non crop activities. However, study reveals that such sources did not achieve the intended objectives because of so many reasons. In addition , they provide loan facility on interest basis and , securing loan on interest basis from any formal or informal institutions is strictly prohibited by *Sharī'ah*for a Muslim farmer. A Muslim farmer, therefore, does not resort to interest-based loans. Being a complete code of life, Islam presents a comprehensive and easy way for farmers, Islamic banks and Islamic financial institutions to enter into various commercial transactions which are viable for stake holders; and also indispensable for the development of agricultural sector both for crop and non -crop activities. These transactions can be divided into *Murābahah, Musāwamah, Salam, Istisnā'*, *Mushārakah, Diminishing Mushārakah, Musāqah,* and *Muzāra'h*, *Ijārah* etc. A qualitative research technique is used in the present work. The theoretical part of the work is mainly based on qualitative research technique and, therefore, is entirely based on secondary data, derived from the work of classical and contemporary Muslim scholars. The work of non Muslim scholars on the same issue (financing agriculture) is also resorted. A focused group technique of qualitative research method is used where the farmers and agricultural credit officers are interviewed. As majority of farmers are illiterate and not in position to understand the technicalities, therefore, each and every proposed model is first explained to them in a very simple way, followed by putting of

various questions related, directly or indirectly, to the models. However, the credit officers are interviewed directly owing to the fact that they were literate and understanding the technical nature of the models. After explaning the proposed models by the researcher, the farmers are asked to openly discuss the same with one another. It is intentionally done in order to develop their own observation regarding the newly developed modls. The data is collected through videos, audios and hand-scribed. Photography is also used for the same purpose. The proposed models are then tested in the light collected data. The data was collected both from urban and rural farmers, living in urban and rural parts of the country. However, more priority was given to rural areas than urban in this regard for being a major hub of agricultural activities. It is reached to the conclusion that a variety of feasible, practicable and viable models can be developed on the basis of such various modes of Islamic finance. The testing of the proposed models through focused group techniques prove that how the newly developed models are very much practicable at ground level, having a potential to fulfill farmers' agricultural needs that start from basic agricultural inputs and ends with heavy agricultural machinery. These can also be used effectively for the development of other sectors of agriculture like livestock, fish farming, dairy faming, poultry farming, and horticulture. However, the intended results from all these models can be achieved with a condition if they are applied in their true spirit which intends primarily to uplift the society and not maximization of profit.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

AC	Agricultural Census
ACD	Agriculture Credit Department
AGR	Agri/Rural Finance
AC	Agriculture Credit
ALA	Agricultural Loan Act
ADFC	Agricultural Development Finance Corporation
ADBP	Agricultural Development Bank of Pakistan
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ABL	Allied Bank Limited
BAAC	Bank for Agriculture and Agriculture Cooperatives
BBS	Bangladesh Bureau of Statistics
BAP	Banco Agrario del Peru
BPLR	Benchmark Prime Lending Rate
CBOs	Collateralized Bond Obligations
CDOs	Collateralized Debt Obligation
CSR	Corporate Social Responsibility
DM	Diminishing *Mushārakah*
FAQs	Frequently Asked Questions
FAO	Food and Agriculture Organization
GA	General Agreement
HBL	Habib Bank Limited
IFPRI	International Food Policy Research Institute
IDB	Islamic Development Bank
IBS	Islamic Banking System
IFIs	Islamic Financial Institutions
IBIs	Islamic Banking Institutions
KIBOR	Karachi Inter-bank Offered Rate
LIBOR	London Inter-bank Offered Rate
LC	Limited Credit
LILA	Land Improvement Loans Act
MFIs	Monitory Financial Institutions
MCOs	Mobile Credit Officers
MMFA	Mastert *Murābahah* Facility Agreement
MMA	Mastert *Murābahah* Agreement
MCB	Muslim Commercial Bank
NDMA	National Disaster Management Authority

NGOs	Non Government Organizations
NBP	National Bank Limited
PBC	Pakistan Banking Council
PPCBL	Punjab Provincial Cooperative Bank Ltd
QH	Qard Hasan
RF	Rural Finance
SES	Socio-Economic Status
SBP	State Bank of Pakistan
SCS	Supervised Credit Scheme
SF	Structured Finance
UBL	United Bank limited
ZTBL	Zarai Taraqiati Bank Limited

CHAPTER 1
INTRODUCTION

1.1 Introduction:

Food is one of the basic necessities that is vital for the nourishment and survival of human life. Agriculture is probably the most important source through which farmers grow food for themselves and others to meet the current and future demands. A considerable portion of the world's labor force is attached to this sector and contributes significantly to the world's economic development. In case of Pakistan, for instance, agriculture accounts for 23% of its GDP, and employs 42% of its labor force.[1]

The work force that is getting its bread and butter from this sector includes both poor and elite classes; however, poor class is more dominant in terms of numbers as far as the local farming is concerned. It is rightly said by C. Peter Timmer, Walter P. Falcon and Scott R. Pearson, "Farmers are remarkably diverse people, ranging from near-subsistence peasants in India and Guatemala to corporate businessmen in California and Sao Paulo".[2] Due to shortage of the financial resources, the people belonging to a low Socio-Economic Status (SES) are unable to get maximum benefit from their efforts. They usually require additional money to cater to the financial needs, arising at different times of the harvesting cycles. For example, at the start of the cycle, money is required to buy basic agricultural inputs like seeds, fertilizers, herbicides, ploughing tools etc. Similarly, during the middle of harvesting cycle, money is required to purchase pesticides, herbicides, weedicides, sprays and different agricultural tools. Since money

---

[1] *Draft Guideline for Livestock Financing*, Agricultural Credit Department, the State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/2006/Guidelines_Livestock_C1.pdf www.sbp.org.pk/acd/2006/Draft-Gls-Livestock-Financing.pdf(accessed: 28th February , 2014).

[2] Peter Timmer, Walter P. Falcon, Scott R. Pearson, Food *Policy Analysis, Analysis of Food Production Systems*, Chapter no.3, World Bank,the Johns Hopkins University Press Baltimore and London.

is required at all stages, and the majority of farmers face a shortage of financial resources, therefore, they borrow it from various sources including individuals, organizations, banks, the government etc. In other words, they fulfill their agricultural requirements through formal and informal institutions of credit.[3]

As agriculture is very much vital to the country's economic growth, and since the government is required to provide food, therefore, most countries try their best to accommodate the financial needs of the agriculture sector by one way or another. These activities/steps include advancement of agricultural loans, giving of subsidiaries over the agricultural commodities, levying off different kinds of taxes etc. The private sector is also playing a vital role in this regard. However, it is only extending the financial loans to farmers.

Agriculture plays an important role in the economic stability of a country. Such a role may be direct or indirect. This is done in three ways; first, agriculture is a main and basic source that provides food, fibber at the local and international level through livestock.[4] Secondly, it produces goods for the international market and becomes a main source of foreign exchange. This means that agriculture enhances export activities of a country by the help of which its economic growth can be determined. Thirdly, it serves as a main market for industrial goods and commodities. In short, it is a source of food, feed, fiber, animals, fertilizers, cut flowers, ornamental and nursery plants, animal hides, leather, industrial chemicals, fuels, and drugs.[5] It also provides employment opportunities and increases the work force. In Pakistan, for instance, it employs 47 percent of the

---

[3]Waiter Schaefer – Kehnert, Jhon D.Von Piodike,*Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.17.

[4]*Agriculture Sector in Pakistan*, Food and Agriculture Organization of the united nation October .1998,http://www.pakissan.com/english/agri.../fao.agricultural.sector.pakistan1.shtml(accessed: 28th February, 2014)

[5]It is rightly said by Kierra DeCamp, Pleaseant Hill FFA, Pleasant Hillthat whenever a person gets up early in the morning and before his feet hit the floor, an industry we all take for granted becomes a part of our life i.e. agriculture .For example the sheet on our bed, the eggs of break fast in our plate, the white milk which we have in a glass in front of our twin eyes, and the clothes at our back are all exist because of agriculture. The times we walk towards the shower room, the floor which we use for walking, the soap, shampoo, conditioner and even the towel which are used therein etc are the outcomes of agriculture by one way or another. In addition, whenever we style our hair, brush our teeth, apply our make up, and start our car, we have already used hundreds of modern agricultural products. In short without agriculture we would be inconvenienced, naked, malnourished, unprotected, and most important hungry ……………………(Kierra DeCamp , Pleaseant Hill FFA, Pleasant Hill,lll, *The Importance of Agriculture in Everyday Life*, http://www.growmark.com/.../Illinois%20Winning%20Essay.pdf(accessed: 28th February , 2014).

labor force. Due to these reasons experts believe that a country rich in agricultural activities will continue to develop.

It has been seen around the world that those involved with agriculture are mostly from a low SES (socio economic status).[7] This includes countries like Latin America, India, Bangladesh, and Pakistan.[8] In the case of India 185 million of the population is from low SES, working in the agricultural sector. [9] Small farmers dominate the agrarian structure of most developing countries.[10] They accept agricultural credit because of lack of capital for running their own farm activities. In case of Pakistan, for example, size of land is small and has decreased over time based on Inheritance in Islamic law. According to Abid Shohab Ahmed, Agricultural Census, there are 5.1 million farms in the country and 93 per cent of these are small and marginal farms that account for 60 per cent of the total cultivated area. In addition, large farms account for only 7 per cent of the total farms for 40 per cent of the total cultivated area. There has been further sub-division of farms because of inheritance and transfer. Since land in the agricultural production process is a requirement, therefore, decreasing the size of the holding has detrimental effect on investment, farm productivity and farm income, resulting in 52 per cent of Pakistanis living under the poverty line.[11] For them agriculture is not a business but a way of life. Due to this reason they are in need of money at the beginning of the season when they need to buy basic agricultural inputs, such as, seeds, fertilizers, insecticides, herbicides, weedicides, and basic agricultural tools, as well as the need to feed their family till to the next harvest.

---

[6]*Agriculture Sector in Pakistan*, Food and Agriculture Organization of the united nation October .1998,http://www.pakissan.com/english/agri.../fao.agricultural.sector.pakistan1.shtml(accessed: 28th February , 2014).

[7]Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, vol. 38, no. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716.

[8]Dale W. Adams, Agricultural Credit in Latin America: *A Critical Review of External Funding Policy*, American Journal of Agricultural Economics, vol. 53, no. 2 (May, 1971), pp. 163-172.

[9]*Strengthening Agricultural support Services for Small Farmers*, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

[10] Waiter Schaefer – Kehnert, Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280, p-4.

[11]Abid Shohab Ahmed, *Agri Overview, Agriculture of Pakistan & Microfinance*. http://www.pakissan.com/.../agri.overview/agriculture.of.pakistan.shtml (accessed: 28thFebruary, 2014).

According to the experts of agricultural finance, if the financial needs of farmers are not addressed, it will impede the agricultural development of the respective country. Currently, farmers turn to public and private financial institutions to get financial assistance in the shape of agricultural loans to fulfill their agricultural requirements, both for crop and non-crop activities. Both these sources provide agricultural loans based on interest despite which the farmer's problem remains unresolved and is further exacerbated because he has to repay the principal amount as well as the interest on loan. It is because the cost of providing credit is independent of the amount of the individual loan.[12] However, this system can be worked in a non-Muslim state and can be used for solution of financial problems faced by a non-Muslim farmer.

The Muslim farmer, however, is prohibited by *Sharī'ah* (Islamic law) to get interest-based loan. There are many verses of the *Qur'ān* and *Sunnah* of the Holy Prophet (SAW) that prohibit interest-based loans.[13] There are several reasons for this prohibition. The most significant among these is the exploitative nature of interest-based dealing where the creditor gets his principal money back along with the interest amount. The exploitation lies in the fact that a debtor is always in a situation to secure loans from the credit at the time of dire need. The creditor exploits this situation where he advances loans with a condition to charge high interest rate from the borrower. The Muslim jurists are, therefore, unanimous that interest leads to injustice, unfairness and exploitation on the part of the debtor. The second reason is that charging interest creates a desire for wealth and reduces the willingness to help neighbors, friends and relatives in times of need. This eliminates or greatly reduces a desired social need and supports commercialization. In short, the creditor looses those characteristics, which are important for a caring society. The third reason is that interest is counterproductive to earning a livelihood through hard work and instead

---

[12]Waiter Schaefer – Kehnert, Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280, p-4.

[13]*Sharī'ah* strictly prohibits interest based loans. There are many verses of the Holy *Qur'ān* and *Hadith* of the Holy Prophet (SAW) that confirms this prohibition. For instance, in the Holy *Qur'ān Allāh,* the exalted, says "O Ye Who Believe! Fear *Allāh,* and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and His apostle. But if ye turn back ye shall have your capital sums: deal not unjustly and ye shall not be dealt unjustly. (*Qur'ān* 2:278-279). In another verse the Lord of Universe says "That they took*Ribā* (usury), through they were forbidden and that they devoured men's substance wrongfully. We have prepared for those among men who reject faith a grievous punishment". (*Qur'ān*4:161)From Jābir, may *Allāh* be pleased with him, said: "The messenger of *Allāh* (SAW) has cursed one who charges *Ribā*,he who gives it, one who records it, and the two witnesses; and he said, "They are equal" (*Muslim Sahīh*, Chapter on *Ribā, Hadīth* no.1598).

creates laziness and lethargy in the creditor in the sense that he does not go for the investment of his money as he can earn a reasonable amount through interest based loans. This also costs the society, as by going towards the trade option he would benefit the society through the provision of employment etc. The other rationale for the prohibition of interest is jurisprudential in nature. For example, according to the established principle of Islamic commercial law, money should always be used as a medium of exchange for goods and, therefore, it should not be used as a source of profit. The reason behind this law is that money has no intrinsic value and as a result no value addition can be made to it. In other words, advancing a loan on the basis of interest does not add value and there is no benefit for the society. A Muslim farmer, therefore, does not resort to interest-based loans. Being a complete code of life, Islam presents a comprehensive and easy way for farmers, Islamic banks and Islamic financial institutions to enter into various commercial transactions, which are viable for stakeholders; and also indispensable for the development of agricultural sector both for crop and non -crop activities. These transactions can be divided into trade based modes, such as, like *Murābahah, Musāwamah, Salam,* and *Istisnā'; participatory* modes, such as, *Mushārakah, Diminishing Mushārakah, Musāqah,and Muzāra'h*; rent based modes, such as *Ijārah* which can be further divided into *Ijārat-ul-Ashkhās and Ijārat-ul-Asyā*. All these transactions have a potential to help a farmer to fulfill his agricultural needs that start from basic agricultural inputs like seeds, fertilizers, herbicides, weedicides, basic agricultural tools and ends with heavy agricultural machinery like tractors, thrashers, harvesters etc. These can also be used effectively for the development of other sectors of agriculture like livestock, fish farming, dairy farming, poultry farming, horticulture etc. However, the intended results from all these modes of Islamic finance option can be achieved with a condition if they are applied in their true spirit, which intends to uplift the society and not maximization of profit.

Selecting the most viable Islamic finance option for the growth of agriculture in Pakistan can be done based on answering a set of questions. These questions include; what will be the structure and mechanism of application? What sorts of agricultural needs can be fulfilled through a particular option? What will be the extent of financial support? How the repayment will be made? How the Islamic banks and other Islamic financial institutions will protect their liquidity? How the securities and other collaterals will be provided by farmers? What will be the benefit of

the financial institutions? What will be the role of the State Bank of Pakistan in this connection? And how rural agriculture can be developed?

This need for Islamic agricultural finance is felt by scholars and researchers from various countries like Sudan, Iran and Pakistan. Scholars conversant with Islamic finance have been encouraged to identify different options in the Islamic financial system and develop a mechanism for their application to agriculture both for crop and non-crop activities. The State Bank of Pakistan, while following the work of Muslim jurists on Islamic agriculture finance, has issued various guidelines on Islamic agricultural finance for Islamic banks and other Islamic financial institutions. For instance, a comprehensive guideline on Islamic agricultural finance[14] is issued by the central bank, including horticulture,[15] poultry farming,[16] fish farming, [17]dairy and meat farming (livestock)[18] etc. While realizing the importance of farmers as a stake holder, special guidelines are issued, enabling them to secure loans from Islamic banks and other Islamic financial institutions with ease.[19] The importance given to agriculture and its sub-sectors can be revealed from the fact that the State Bank of Pakistan has established a separate department for agricultural credit called the Agriculture Credit Department. Zarai Taraqiati Bank Limited (ZTBL) was also established which is the premier financial institution for the development of the agricultural sector by providing financial and technical services. These facts show the appreciable level of seriousness, although very late, paid by the state to the agricultural sector. However, at the individual level no effort was made.

[14]*Guidelines on Islamic Finance for Agriculture*, the Agricultural Credit Department, Islamic Banking Department, State Bank of Pakistan, http:// www.sbp.org.pk/guidelines/IslamicAgriculture/Guidelines-Islamic-Financing-Agriculture-01-09-2008.pdf (accessed: 28th February, 2014).

[15]*Guidelines for Horticulture Financing*, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/guidelines/Horticulture/Horticulture_Guideline.pdf (accessed: 28th February, 2014).

[16]*Guidelines for Poultry Financing*, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2007/Draft-Guidelines-Poultry-Financing.pdf (accessed: 28th February, 2014).

[17]*Guidelines for Fisheries Financing*, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2007/Guidelines-for-Fisheries-Financing.pdf (accessed: 28th February, 2014).

[18]*Guidelines for Livestock Financing*, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2006/Guidelines_Livestock_C1.pdf (accessed: 28th February, 2014).

[19]See for example *Financing Scheme for Small Farmers*, Agricultural Credit Department, State Bank of Pakistan(accessed: 28th February , 2014);*Frequently Asked Questions (FAQs) On Agri Financing*,Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/ACD_FAQs.pdf(accessed: 28th February , 2014).

A closer scrutiny of the options offered under Islamic financial services shows that these options are not suitable for farmers living below the poverty line.[20] For example, they include a strict eligibility criterion for a borrower,[21] such as requiring for collaterals[22] and high interest rate (ranging from 10 to 20 percent and up to 20 percent in Barani Punjab, and 17 per cent in Baluchistan).[23] The State Bank of Pakistan has given a free choice to all conventional banks to charge interest rates according to their credit policy (from farmers majority of whom live below the poverty line). In a guideline, which is issued for financing small loans for farmers, it is stated "Bank shall determine mark-up on the basis of KIBOR and their cost of funds in line with their credit policy."[24] This official document shows the interest rate charged from poor farmers on agricultural credit is purely based on the concept of profit maximization.

Surprisingly the interest rate is relatively low in India as compared to the rate of interest in Pakistan. In the Budget for the Years of 2006-2007, it was announced that farmers would receive a loan up to the principle amount of three hundred thousand at 7 percent rate of interest. Some reliefs were also provided in the same budget, such as, provision of a sum of 1700.00 crores for the practical implementation of their policy to the agricultural sector in the union budget for the years of 2006-2007.[25]

---

[20]Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, Vol. 38, No. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716.

[21]See for example the eligibility criteria of the state bank of Pakistan for the provision of agricultural loan "……………the loan limit shall be assessed by bank keeping in view the borrowers profile, feasibility of the business, cash flow etc as per bank's credit policies. Banks should undertake due diligence and market survey to assess the prices of equipments, vehicles and all other goods". visit for further details www.sbp.org.pk/acd/ACD

[22]See for example the list of securities mentioned by the State Bank of Pakistan for agricultural credit. It states in the guide line on agricultural finance "Banks are advised to secure their financing to safeguard the interest of the bank and facilitate borrower as per their lending policies. Security and collateral may include, Charge on agricultural land through passbook system, personal surety, hypothecation/mortgage of assets e.g. incubators, feed mill machinery, generator & refrigerators etc, mortgage of rural, urban or commercial property, Pledge of SSC/DSC, lien on bank deposit, bank guarantee, Pledge of gold and Gold jewellery, Individual/Group Guarantee (maximum per person exposure as mentioned in PRs for agriculture regarding personal guarantee), any other tangible collateral security acceptable to bank". http://www.sbp.org.pk/acd/ACD(accessed March 3, 2013)

[23]Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab*, European Journal of Scientific Research, vol.23, no.2 (2008), pp.294-304.

[24]*Financing Scheme for Small Farmers*, Agricultural Credit Department, State Bank of Pakistan.

[25]Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab*, European Journal of Scientific Research, vol.23, issue no.2 (2008), pp.294-304.

An attempt will be made in the present work to find out a solution to the above mentioned problems that would be acceptable to farmers of all SES as well as Islamic banks and other Islamic financial institutions. Some scholars have already started work on presenting options for Islamic finance, such as, *Salam* (advance payment sale)[26], however, it does not cover everything in Islamic agriculture finance. Pakistan, being an Islamic and agri-based country, for the past 64 years no substantial developments has been made even in the theoretical mechanism of Islamic agricultural finance.[27] As a result, the country's farmers, majority of whom belongs to Islamic faith, are facing with a dilemma regarding the use of financial loans that should be in line with their religious beliefs and the constitution of Pakistan, which clearly states,

> "Wherein the Muslims shall be enabled to order their lives in the individual and collective spheres in accordance with the teachings and requirements of Islam as set out in the *Qur'ān* and *Sunnah*"[28]

It is, therefore, the duty of the scholars who are knowledgeable in the field of Islamic finance to discover ways in Islamic agricultural finance and put forward new ideas for its practical implementation.

1.2 Objectives of the Study:

The basic objectives of the present work are

1. To analyze and investigate the viability and efficiency of contemporary models, used by conventional banks for financing agriculture.
2. To analyze, legal and economic issues in the current conventional agricultural finance.
3. To explore viability of Islamic modes of finance for agricultural finance, both in crop and non-crop activities.

---

[26]Ahmad Kaleem, Rana Abdul Wajid, (2009) "*Application of Islamic Banking Instrument (Bay' Salam) for Agriculture Financing in Pakistan",*British Food Journal, vol. 111, issue: 3, pp.275 – 292.
;Ahmad Kaleem and Saima Ahmad, *Bankers' Perception Towards Bay' Salam Method for Agriculture Financing in Pakistan*, Journal of Financial Services Marketing 15,pp. 215-227 (December 2010).

[27] The statement is made by the researcher form the profound review of existing literature which is available on Islamic agricultural finance in Pakistan.

[28] Preamble of the Constitution of Pakistan, 1973

4. To suggest *Sharī'ah* based models for financing agriculture, particularly for local farming. These models are structured in a simple way as compared to other models presented for financing agriculture in the past that were not very successful in achieving the desired goals. Another objective is to build in various objectives of Islamic financial system in the proposed models for financing agriculture. These objectives focus on supporting poor fractions of society, prosperity of society, equal distribution of wealth, poverty elevation, enhancing investment opportunity, priority of collective interests and public interests over individual interests, facilitating others, condemning exploitation, countering fraud etc.
5. To analyze *Sharī'ah* issues in the current guidelines issued by the State Bank of Pakistan for financing agriculture through Islamic modes of finance. All other guidelines, related to agricultural finance by one way or another, will also be studied on the same way.

1.3 Statement of the Problem:

The flexible nature of Islamic commercial law ensures the effective application of Islamic agricultural finance to all sectors of agriculture, particularly local farming. However, it is conditioned with if all transactions of Islamic commercial law, particularly those related to Islamic finance, are applied in their real spirit and not mere as sources for profit maximization.

1.4 Hypothesis:

Based on the exhaustive literature available on formal, informal and Islamic agriculture finance, the following hypothesis needs to be examined that:

1. Islamic finance has great potential to meet all types of needs of agriculture sector including local farming, dairy farming, poultry farming, fishery farming, horticulture etc.
2. By applying Islamic agricultural finance to the agricultural sector in its true spirit and philosophy, the desired objectives of Islamic financial system, such as, prosperity for the society, and improving the living standards of farmers (both at the individual and collective levels) can be effectively achieved .
3. The existing conventional agricultural finance in the country has failed badly to meet needs of all classes of farmers, especially local farmers living in rural areas. The legal

and economic analysis of the existing agricultural finance shows this failure beyond any doubt.

4. The application of Islamic agricultural finance is feasible, practicable and viable for all stake holders, such as, Islamic banks, Islamic financial institutions and conventional banks' Islamic windows.
5. There are many *Sharī'ah* issues in the existing State Banks' rules and regulations for financing agriculture through the Islamic modes of finance.

1.5 Research Questions

There are some questions that must be answered in the present work. These questions include

1. Has the existing conventional agricultural finance failed to bring positive socio-economic change in farmers' life?
2. Whether any legal constraints exist in the current conventional agricultural credit policy?
3. What agricultural financial models can be constructed in Islamic framework which can address empirically tested evidence in the field? Can various models be developed on the basis of various modes of Islamic finance like *Murābahah, Salam, Istisnā'*, *Mushārakah, Diminishing Mushārakah, Musāqah, Muzāra'ah* and *Ijārah* to full basic requirements of different agricultural sectors, particularly that of local farming?
4. How for the newly developed models are viable and practicable at ground level?
5. Whether the guidelines, issued by the central bank for financing agriculture, are purely based on principles of Islamic commercial law?

1.6 Methodology of the Study

The research methodology in the present work is predominantly qualitative in nature. It does not mean that a major part of such study is theoretical in nature, and therefore, the focused group technique is also conducted through interviews sessions for the purpose to check the viability of Islamic modes of finance and their level of acceptance for the farmers, particularly those related to local farming. While applying the qualitative methodology, the literature available on Islamic agriculture finance in the classical work of Muslim jurists has thoroughly studied and discussed. The basic principles, rules and regulations of Islamic modes of finance, mentioned in such work, are rigorously followed in order to eliminate gap between theory and practice (as some of the

opponents of the existing Islamic financial system criticize that the current Islamic banks and other Islamic financial institutions do not follow the theory of Islamic commercial law in its real spirit and they always look for subterfuges). In addition, the contemporary Muslim scholars' work on Islamic agriculture finance is exhaustively studied and referred.[29] Besides, the academic efforts of non-Muslim jurists on agriculture finance from various aspects have been resorted to in the present work.[30] The present study is peculiar in the sense that it mingles the work of classical and contemporary jurist on the same line.

---

[29]See for example the work of Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes And Instrument: Practical Scenario And Applicability*, (Jeddah Saudi Arabia: Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34 ; Hassan Yusuf Dawood, *Al Masraf ul Islāiī lil Istismāre al Zirāī ' " Namozaj Muqtareh*" , Dra al Nushr lil Jameat Misr(Al Qahera), 1st Edition 2005; Aziz, Muhammad Ridhwan (2012), *Agriculture in Islam From the Perspective of Economics, Banking &Finance*. Penerbit UTM, Skudai, Johor Bahru. ISBN 978–983–52–0840–9, http:// eprints.utm.my/30174/(accessed: 31th January, 2014); Al-Hashimi, Muhammad Ali Alula, 1989. *The Influence of Islamic Banking on Agricultural Development in Sudan*,Graduate Research Masters Degree Plan B Papers 10994, Michigan State University, Department of Agricultural, Food, and Resource Economics; Ahmad Kaleem, *Outlook for Islamic Financing of Agriculture*, March 2007, http://www.pakissan.com/.../outlook.for.islamic.financing.of.agriculture.shtml (accessed: 15th February, 2014); Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq, Malka Yasmeen, *Role of Islamic Banking in Agriculture Development in Bahawalpur, Pakistan* ,International Journal of Learning & Development ISSN 2164-4063 2012, vol. 2; Naeem Ur Rehman Khattak Khattak,Anwar Hussain, *A Review of the Principles of Islamic Banking System for Agriculture Credit*, Pakistan, Institute of Development Economics Islamabad Pakistan 2006, MPRA Paper No. 42038, posted 18. October 2012 07:42 UTC; Saeed Yazdani, *An Evaluation of Agricultural Credit System in Iran, Savings and Development*, Giordano Dell-Amore Foundation, Vol. 29, No. 2 (2005), pp. 117-132; Badawi B. Osman, *The Experience of the Sudanese Islamic Bank in Partnership (Mushārakah) Financing as a Tool for Rural Development among Small Farmers in Sudan*, Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 221-230; Haroon Rasheed ,Muhammad Mudassar, *Research on Innovative Models of Islamic Banking Product for Pakistani Farmers*, Proceedings of the 7th International Conference on Innovation & Management,http://www4.pucsp.br/.../26_Research%20on%20Innovative%20Models%20of(accessed:22nd February , 2014).

[30]See for example the work of W. A. Lawal, I.Babdullahi, *Impact of Informal Agricultural Financing on Agricultural Production in the Rural Economy of Kwara State, Nigeria*, International Journal of Business and Social Science vol. 2, no. 19 [Special Issue -October2011]; Christopher B. Barrett, *The Economics of Agricultural Development: An Overview*, p.3,
http://dyson.cornell.edu/.../Introduction%20Chapter%201%208June2011%20(accessed june29, 2013); Waiter Schaefer – Kehnert, Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280; Richard L. Meyer,*Subsidies as an Instrument in Agriculture Finance: A Review*, Joint Discussion Paper – Issue, German Federal Ministry Of Economic Cooperation and Development (Bmz), Food and Agriculture Organization of the United Nations (Fao), German Agency For International Cooperation (Giz), International Fund For Agriculture Development (Ifad), The World Bank, And United Nations Capital Development Fund (Uncdf), chapter 5,p.11; Rewa Misra, Primary Agricultural Credit Society Linkage, India: The Best Remote Rural Self-Help Groups Can Do?, (Case Study), the Coady International Institute, June 2008; Calvin Miller, *Microcredit and Crop Agriculture: New Approaches, Technologies and other Innovations to Address Food Insecurity among the Poor*, 2011 Global Microcredit Summit Commissioned Workshop Paper November 14-17, 2011 – Valladolid, Spain; Lamon Rutten ,*Innovative Agricultural Finance and Risk Management Strengthening*

A focused group technique of qualitative research method had used where the farmers and agricultural credit officers were interviewed. Approximately three hundred farmers had selected from various parts of the country and were then dived into various small groups. As a matter of fact, farmers usually live in scattered areas; therefore, it was extremely a difficult task to take a sample size of more than three hundreds. As majority of farmers were illiterate and not in position to understand the technicalities, therefore, each and every proposed model was first explained to them in a very simple way, followed by putting of various questions related, directly or indirectly, to the models. However, the credit officers (agricultural credit officers of those financial institutions which are directly involve in financing agriculture) were interviewed directly owing to the fact that they were literate and understanding the technical nature of the models. The data was collected through videos, audios and hand-scribed. Photography is also used for the same purpose. The proposed models were then tested in the light collected data. The data had been collected both from urban and rural farmers, living in urban and rural parts of the country. However, more priority was given to rural areas than urban in this regard for being a major hub of agricultural activities.

Some of the respondents had shown shilly-shallying to answer all or some of the questions and hence the intended target of respondents (to be interviewed) was not achieved. It is pertinent to mention that the sample data was not taken from one particular area rather it had been collected from several areas including both urban and rural. In addition, the typical rural areas in the Northern part of the country like the district of Bajawar Agency, Mohmand Agency, Khyber

---

Food Production And Trade in the Transition Region, Working Paper, Prepared under the FAO(Food and Agriculture Organization of the United Nations) /EBRD(European Bank for Reconstruction and Development Cooperation),p.28; Nachiket Mor, D Chattanathan and Rajiv Panthary, *Enhancing the Flow of Credit and Managing Risks in Agriculture*, Institute for Financial Management and Research Centre for Development Finance Working Paper Series August 2006,p.18; Peter J. Barry, C. B. Baker and Luis R. Sanint ,*Farmers' Credit Risks and Liquidity Management*, American Journal of Agricultural Economics, vol. 63, no. 2 (May, 1981), pp. 216-227, Oxford University Press on behalf of the Agricultural & Applied Economics Association, http://www.jstor.org/stable/1239557(accessed July 30, 2013); Bruce J. Sherrick, Peter J. Barry and Paul N. Ellinger, *Valuation of Credit Risk in Agricultural Mortgages*, American Journal of Agricultural Economics, vol. 82, no. 1 (Feb., 2000), pp. 71-81, Oxford University Press on behalf of the Agricultural & Applied Economics Association; Ani L. Katchova and Peter J. Barry. *Credit Risk Models and Agricultural Lending*, American Journal of Agricultural Economics, vol. 87, no. 1 (Feb., 2005), pp. 194-205, Oxford University Press on behalf of the Agricultural & Applied Economics Association; Jerome M. Wolgin, Resource Allocation and Risk: A Case Study of Smallholder Agriculture in Kenya, American Journal of Agricultural Economics, vol. 57, no. 4 (Nov., 1975), pp. 622-630, Oxford University Press on behalf of the Agricultural &Applied Economics Association.

Agency, Darra Adam Khan, South and North Waziristan Agency were not visited due to the law and order situation in these areas. However, this deficiency had been eliminated to a great extent, as the data collected from other rural areas was sufficient in nature to fulfill the required objectives.[31] Besides this, frequent visits were made to all those institutions,[32] public or private, which are directly or indirectly involved in agricultural financing in order to practically examine their existing policies, products, rules and regulations, past success and failures in financing agricultural sector, and their future planning and programs. In this regard, credit officers, who were involved in agricultural finance, had been interviewed with a variety of questions. Some of the financial institutions, especially those that directly involved in financing agriculture through Islamic modes of finance, were requested to provide detailed documentation of their agricultural financing policies and practices. In addition, a request was also made to such financial institutions to provide some of the past contracts concluded with farmers. The Askari Islamic Bank Limited had provided a great support in this regard. It helped the researcher to critically scrutinize the existing Islamic agricultural financial system offered by the Islamic banks, Islamic financial institutions and conventional financial institutions' Islamic windows in Pakistan in the light of basic principles and objectives of Islamic commercial law. Most of the research materials particularly those related to the work of classical Muslim jurists were collected from library's sources, while others related to the work of contemporary Muslim and non-Muslim scholars, were mostly accumulated from web resources i.e. articles, reports, magazines, newspapers, case studies etc. The translation to the verses of the Holy *Qur'ān* throughout the thesis is referred to 'Abdullah Yusuf Ali[33] while traditions of the Holy prophet (SAW) were cited directly from the authentic books of *Hadith*. Moreover, the effort is made to translate the basic '*Arabic* terminologies, used in the present work into English language.

---

[31]The rural areas, from which the data sample is collected, have the same agricultural environment like those areas that are facing critical law and order situation. Based on this fact, the obtained information can be presumed alike for those areas, which are not visited. Similarly, the models that are presented in this study (based on the information collected through data) can be applied latter on for the growth of agriculture sector both in crop and non-crop activities in Northern areas of the country.

[32]Like ZTBL(Zarai Taraqiati Bank Limited);Agricultural Credit Department of State Bank of Pakistan;NBP(National Bank of Pakistan), HBL (Habib Bank Limited) and etc.

[33]Abdullah Yūsuf Alī, the Holy *Qur'ān* (original Arabic text with English translation).

1.7 Scope and Limitation of the Study

The present research is connected with the development of *Sharīʻah* based models and their application to different sectors of agriculture, such as, local farming, dairy farming, fish farming, horticulture, poultry farming etc. All these sectors play a key role in the social and economic development of Pakistan. Due to this reason, all these sectors are studied thoroughly in term of their basic needs for infrastructure at primary level, followed by other requirements for their maintenance and future growth. In the very beginning of the current study, their financial needs were studied, determined by their basic requirements, along with the discussion that how all these can be fulfilled appropriately through the application of Islamic financial transactions. However, the focus of the present work in the present work is local farming including crop and non-crop sectors. This propensity is indispensable because of some unalienable reasons. Firstly, local farming has dominancy over other sectors of agriculture as majority of the population belong to this sector of agriculture directly or indirectly. Secondly, it is more significant for human life as compared to other sectors of agriculture owing to the fact that it is a source through which farmers grow food for themselves and others to meet the current and future demands. A considerable portion of the world's labor force is also attached to this sector, and it contributes significantly to the world's economic development. Thirdly, majority of farmers related to this sector belong to lower class, particularly those of rural areas, and hence the Islamic banks/Islamic financial institutions and conventional banks feel hesitant to allocate a reasonable portion of their liquidity to such sector for financing purposes. They are also reluctant due to poor infrastructure;for example bad roads, erratic electricity supply, and lack of communications systems; which impedes effective outreach to customers. The legal environment in these rural areas is also not satisfactory in nature.[34] Being a backbone of agriculture, local farming has been discussed exhaustively as compared to other sectors of agriculture.

There are some other inevitable limitations to the present work. Firstly, the works of classical Muslim jurists do not discuss various modes of Islamic commercial law with specific reference to Islamic agricultural finance. In other words, exhaustive literature is not available on Islamic

[34]Thierry Mahieux, Omer Zafar, and Mylène Kherallah "*Financing Smallholder Farmers and Rural Entrepreneurs through IFADsupported Operations in the Near East and North Africa*", Paper presented at the IFAD Conference on New Directions for Smallholder Agriculture24-25 January, 2001.

agricultural finance in the classical work of Muslim Jurists. This was a limitation for the author to elaborate the concept of Islamic agriculture finance in the broad spectrum of Islamic commercial law discussed by these Jurists. Therefore, the available literature on Islamic agricultural finance, either contributed by contemporary Muslim or non-Muslim jurists, is frequently cited in the present study as evidence.

Majority of farmers live in rural areas of the country, and hence, the data was collected from the same regions. The viability and efficacy of Islamic modes of finance for financing agriculture has tested on the same data. The structure of new proposed models is revisited in the light of results obtained from the collected data. Therefore, the models presented in the work would be more beneficial and applicable for local farming that exists in rural parts of the country then that of urban area. However, very minor changes, which are based on data collected from urban areas, may overcome this deficiency to a great extent.

The second limitation is linked to the collection of data from farmers who were actively involved in agriculture but were, at times, unable to comprehend the researcher's questions due to lack of education. [35] Although most participants answered the questions precisely, some were reluctant to talk and show basic knowledge of agricultural finance, such as, agricultural credit, good quality fertilizers, herbicides, weedicides, agricultural bank, and agricultural subsidies. Participants were reluctant to give answers to some simple questions, such as, what are your basic agricultural requirements in the beginning of a season? Do you own any property? What types of tools do you require for agriculture? Have you ever visited a bank? Do you know that the government wants to help you and other farmers? Therefore, the sample data is based on two set of information ;(a) the actual answers given by the respondents and (b) the self-presumed answers based on the already obtained data.

A third limitation is linked with Islamic banks, Islamic financial institutions, conventional financial institutions and specialized agricultural financial institutions. These financial institutions showed reluctance to provide previous records related to financing

---

[35]See for example the study of Mohsin Ali, *Agriculture Problems in Pakistan and Their Solutions*, March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013);Renate K Loeppinger-T Odd And Manohar Sharma, *Innovations in Rural and Agriculture Finance*, J uly 2010, the International Food Policy Research Institute (IFPRI).

agriculture, however, later on they agreed to provide very few transactions and that too with certain conditions. This situation made it difficult to know about the past agricultural financing practices in detail. Due to the limited information no proper suggestions could be provided to reform the existing structure. However, this problem was resolved by using data available through web sources.[36]

The current study on financing agriculture is based on evidence from Islamic commercial transactions in Pakistan with a focus on rural finance. Therefore, the models developed in this work may be studied and applied in the context of Pakistan and may not be relevant for the agriculture sectors in other parts of the world. Some modifications in rules and regulations must be made before applying in the other contexts.

1.8 Organization of the Study:

The present work is divided into six chapters. Chapter one deals with the introduction, purpose and significance of the current study. This chapter is introductory in nature and covers all relevant topics such as hypothesis, research questions, objectives of the study, limitation of the study, organization of the study etc. It also deals with the methodology, followed by the various issues which are directly or indirectly related to agricultural financing, pursued by a detailed discussion related to objectives of the present work and comes to an end while describing its limitations and scope.

Chapter two presents the literature review on agricultural finance. It deals with literature available on agricultural finance, informal agricultural finance, formal agricultural finance and Islamic agricultural finance. The concluding part, Islamic agricultural finance, is further divided into two types. Firstly, the literature available on Islamic agricultural finance in the classical work of Muslim jurists, followed by the literature on the same issue produced by contemporary Muslim and non-Muslim scholars.

---

[36]It is a matter of actuality that many scholars in past had done a fabulous work on agriculture finance from various perspective. Some of these scholars had a very close relation with financial institutions in various capacities and hence were in position to get the required data from such financial institutions for their research. After getting the required data they studied critically the existing mechanism and structure of various models used for financing agriculture and its various sectors. A lot of help had been taken from the work of such scholars in the present work.

Chapter three presents an overview of formal and informal agricultural finance in Pakistan, and, highlights its merits and demerits with minute details. The merits of both formal and informal finance are incorporated in the proposed models in order to make them more viable.

The fourth chapter provides a thorough analysis of legal and economic issues involved in the existing agricultural financing. In this connection, the legal issues, identified by various legal experts in the contemporary agricultural credit system, have been discussed. In addition, some amendments and alterations in the existing laws are proposed for the purpose to establish a progressive legal mechanism that can solve all agricultural disputes effectively. Moreover, the agricultural credit is also critically analyzed from its economic impact on farms production and farmers' social life. The chapter concludes that the existing agricultural finance, its legal mechanism and its economic structure are facing shoddier failure to solve the farmers' problems and their agricultural needs and, therefore, needs to be exhaustively revised.

Chapter five is devoted to study of *Sharī'ah'* Based Models for Financing Agriculture, with reference to Pakistan, which includes *Mushārakah, Diminishing Mushārakah, Musāqah, Muzāra'h, Murābaha , Musāwamah, Salam, Istisnā', Ijārat*-ul-*Ashkhā* and *Ijārat*-ul-*Asyā* based models. Before presenting the proposed models for Islamic agricultural finance, the basic theory of various modes of financing is discussed. The proposed models, then, has been tested through an exhaustive data sampled from the farmers and other stakeholder of agricultural finance. It is calculatedly done in order to in line the projected models in such a way, which can be effectively applied for the solutions of farmers' problems.

Chapter Six is *Sharī'ah* analysis of various guidelines issued by the State Bank of Pakistan for financing agriculture. These guidelines include Guidelines on Islamic Finance for Agriculture, Guideline for Financing Scheme for Small Farmers, Guideline on Frequently Asked Questions (FAQs) On Agri Financing, Handbook on Best Practices in Agri/Rural Finance, Prudential Regulations for Agriculture Financing, Definition of Agricultural Terminologies, Guidelines for Islamic Micro-Finance Business, Guidelines for *Sharī'ah's* Compliance for Financial Institutions, Guidelines for Commercial Banks to Undertake Micro-Finance Business etc are critically analyzed from *Sharī'ah* perspective. However, Guideline on Islamic Agricultural finance is more critically analyzed as compared to others.

CHAPTER 2

LITERATURE REVIEW OF INFORMAL, FORMAL AND ISLAMIC AGRICULTURAL FINANCE

2.1 Literature Review

2.1.1 Literature Review of Informal Agriculture Finance

Agriculture is one of the most important source for food and hence indispensable for the endurance of human life. It is a significant innovation of the human being that has been created and recreated, adopted and developed, invented and discovered over the centuries.[37] Its expansion has spanned over four thousand years; however, its present shape is a product of the last two and half centuries. In such duration, a significant growth has been made in both crop and non-crop agricultural activities. Presently, not only farmers but also organizations and academic institutions are joining hands for the introductions of new dimensions and practices in order to make agriculture more fruitful and in line with the modern needs of society. The researchers also contribute positively in this regard.

In the last two and half centuries many have written about agricultural finance discussing both formal[38] and informal[39] institutions that could provide financial support and assistance for the expansion of agriculture. That work, however, in the beginning was predominantly related to

---

[37]Gwyn E. Jones, Chris Garforth,*the History, Development, and Future of Agricultural Extension*, Chapter 1, Natural Resources Management and Environment Department,1997, http://www.fao.org/docrep/W5830E/w5830e03.htm (accessed April 10, 2013).

[38]Formal financial institutions means those institutions which are registered, licensed and regulated by a specific national authority. These institutions include banks(including both public and private banks), insurance companies,macro finance institutions (MFIs),government funded bodies ,formal money transfer service providers ,NGOs etc. These institutions are called formal in the sense as they follow certain rules and regulations prescribed by the concerned country in which they exist…*Study onInformal and Non-Formal Rural Financial Services Concern Universal*, Final Report, June 2012, pp.8-9. http:// www.concernuniversal.org/.../_universal_malawi_study_on_inform... (accessed April 10, 2013)…..(This report was conducted by Kadale consultants in March and April 2012 .

[39]The formal sources include lending and gift from relatives, merchants, friends and local money lenders.These sources are usually non-governmental. The farmers have more inclination towards the informal sources of finance as compared to formal sources; as the previous are more flexible in terms of procedure and repayment structure.

informal sources of funding such as personal loans between family and friends as these were more prevalent among farmers for several reasons. First, the farmers were familiar with these sources because these were a part of their customs. This made for easier data collection by the researchers in order to improve the existing available structure and composition of these loans. Second, farmers had a predisposition toward these sources as they were more flexible in terms of repayment schedules.[40] Third, the majority of these loans were initially advanced on a non-interest basis and, therefore, did not put any added burden on the farmer. Fourth, such loans required a very simple procedure to be followed by the farmer as a debtor and by the other party (usually friends, relatives, or local money lenders) as a creditor. This led to the availability of loans at the time when it was precisely needed by a farmer particularly at the beginning of a season to buy basic agricultural inputs like seeds, fertilizers, insecticides, herbicides, and other basic agricultural tools.

There are some well-known research contributions on informal sources of agricultural financing provided by experts in the field. Among these, the work of Luc Tardieu[41] is very important because informal sources are dissected thoroughly. Tardieu's study covers various issues related to informal financing sources with evidence from the ground authenticity. For example the work explains that informal sources are based on soft information rather than hard information (i.e. in informal sources the parties possess the needed information as they have face to face relationships, they have other more efficient means of enforcement than a legal system, the borrower can easily monitor the behavior of the borrower, etc.). Other studies agree on these same characteristics of informal sources.[42] However, their work is very limited in terms of its applicability as it only relates to the existing structure of informal sources of financing in Bulgaria. Therefore, the findings may not be appropriate or generalizable for other regions as informal sources' structure and composition diverge from place to place and time to time.

---

[40]Waiter Schaefer – Kehnert, Jhon D.Von Piodike, *Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.4.

[41] Luc Tardieu, Informal *Sources of Credit and the "Soft" Information Market (Evidence from Sofia)*, March 2007, Discussion Papers, Bulgarian National Bank Publications Division, series, 2007.

[42] Pe ter Quartey, Cris Udry,Seidu Al Hassan, Hellen Seshie, *Agricultural Financing And Credit Constraints: The Role Of Middlemen in Marketing and Credit Outcomes in Ghana*, Working Paper 12/0160March 2012, IGC Project.

informal sources of financing have a great impact on agriculture production particularly on local farming of rural areas. Laval and Abdullah[43] found that farmers in rural areas rely mainly on informal sources of agricultural finance. They conducted an empirical study where the primary data was collected while using a structured questionnaire that sampled farmers who had secured loans from informal sources. Their analysis of the collected data confirmed that informal resources have a very positive impact on agricultural production. They recommend that rotating loans should be used for financing agriculture chiefly for that of rural areas along with the improvement of other informal financing sources. Nevertheless, the results of their work can not be considered generalizable for making agricultural financial policies in other countries. The rationale is that such research has been conducted on the basis of data that was collected from a particular locality (for example, the area of Kawara State in Nigeria). Even though the return rate of their questionnaires could be considered high (1249 of 1350 questionnaires distributed among farmers who had been participating in informal financial schemes, were returned), the reliability of the results can be questioned due to the study being based entirely on such specified locally collected data..

A vital contribution to the literature on agricultural financing, illustrating the importance of informal sources in the enrichment of agricultural production was provided by two of the most prominent agricultural economists, George Owuor and A.O. Shem.[44] They have verified that securing formal credit is almost impossible especially for small farmers and, consequently, they mostly rely on the least regulated informal sources. Other comprehensive reports on agricultural financing have the same view.[45] Such informal sources provide loans to small farmers using a

---

[43]W. A. Lawal, I.Babdullahi, *Impact of Informal Agricultural Financing on Agricultural Production in The Rural Economy of Kwara State, Nigeria*, International Journal of Business and Social Science vol. 2, no. 19,Special Issue – October 2011.

[44]Owuor George, Shem A.O ,*Informal Credit and Factor Productivity in Africa: Does Informal Credit Matter?*, Selected Poster Prepared for Presentation at the International Association of Agricultural Economists (IAAE) Triennial Conference, Foz do Iguaco, Brazil, 18-24 August, 2012.

[45]See for example report on *Raising Agricultural Productivity in Africa, Options for Action, and the Role of Subsidies*, Africa Progress Panel Policy Brief September 2010 (This policy brief has been prepared by the Africa Progress Panel Secretariat in collaboration with the Future Agricultures Consortium that brings together researchers in Africa and the UK. The main authors are Steve Wiggins and Henri Leturque from Overseas Development Institute. The paper has benefited from insights and comments from Ousmane Badian of IFPRI, Jonathan Brooks of

group basis. They empirically establish that this type of lending has a noteworthy effect on the rate of production. They also noticed through the analysis of their collected data, provided by 401 respondents (180 borrowers and 221 non-borrowers), that 20% of such loans are used for non-productive activities. This frustrates the intended purpose of such credits. They suggest that such issues can be solved through supervision or through the issuing of credit in the form of various inputs such as fertilizers, planting materials, crop chemicals (i.e. insecticides, herbicides, etc.), various agricultural tools, and other related items. Their research paves a way for the detection of new dimensions in group based lending and its importance in agricultural production's increase through improved factors. However, such research mainly focuses on group based lending and its impact on the augmentation of agricultural yield, while ignoring other important aspects of informal sources like the issuance procedures of such loans, the detailed reasons for farmers' perception towards such loans, their recovery mechanisms, the monitoring system, etc. Additionally, the authors' collected data sample from a less developed country (i.e. Kenya) and the results may be questioned when compared to a group based lending system in a more developed or developed country.

The informal sources of agriculture finance play an essential role in the development of agriculture activities in the rural areas of a country as compared to its urban areas. Lack of accessibility of rural farmers to formal credit is the most important reason for this situation. The research work of Calum G.Turvey and Rong Kong [46] profoundly discusses the trust and strength of informal lending in the rural areas of China. Their study reveals that two thirds of the farmers, surveyed, borrow from informal sources (i.e. friends and relatives). Some researchers established that such loans are very flexible in term of repayment and have a very low interest rate and, therefore, the farmers have more of an inclination towards these credit options as compared to

---

OECD, Brantley Browning of the Bill and Melinda Gates Foundation, Stephen Carr in Malawi, Gordon Conway, Glenn Denning of Columbia University, Andrew Dorward, SOAS University of London, and Peter Hazell. The APP Secretariat would like in particular to acknowledge the comments and cooperation of AGRA in the production of this brief, notably Akin Adesina, Namanga Ngongi and Tesfai Tecle………………see for further details of the report http:// www.africaprogresspanel.org/index.php/download_file/view/697/accessed May 5th , 2013).

[46]Calum G. Turvey, Rong Kong, Informal *Lending Amongst Friends and Relatives: Can Microcredit Compete in Rural China?*,Paper Submitted for CERMI, First European Research Conference on Microfinance 2-4 June 2009, Brussels, Belgium Wednesday, March 25, 2009.

those that are more formal.[47] However, Turvey and Kong consider the strong community trust found in these rural areas making the farmers favor this method for securing such loans. Because of this trust, 97% of the credit is repaid. The work of these authors, however, is not comprehensive as it entirely focuses on the role of trust affecting informal credit facilities. There are many other reasons for the farmers' tendency towards informal credit systems, including simplicity of the procedure, no formal documentation, ease in supervision of the credit, flexible repayment schedules, low interest rates, decent recovery methods, etc.

Some of the scholars present distinguished academic work in order to substantiate the less risky nature of the informal agricultural credit system. In their view, an attentive analysis of the formal credit system and informal credit system explains that the latter is less risky in nature and, therefore, the informal lenders do not hesitate to advance such loans to the local farmers. The research of Catherine Guirkinger is quite noteworthy when she explains this connection.[48] She elaborates that in case of default; the lender usually does not resort to the court of law for the recovery of the loan but instead solves the issue through private negotiation. Some time social forces are used for the same purpose. Due to strong and efficient social force, the borrower is compelled to pay the loan as agreed. In addition, the interests are generally frozen in the informal credit system and, thus, even after the default, the farmer has to pay the originally agreed amount. Such flexibilities are not available in the formal credit system.

Some of the scholars, on the other hand, have a different approach towards informal sources of agricultural finance. Among these scholars, the work of Walter Schaefer-Kehnert and John D. Von Pischke is remarkable in nature.[49] They have a view that informal loans usually involve small amounts that are not sufficient enough to fulfill all agricultural requirements of a

---

[47] Walter Schaefer – Kehnert and Jhon D.Von Piodike "Agricultural credit policy in developing countries", World Bank Re Print Series: Number 280, 1982.p.4,http://www-wds.worldbank.org/external/default/.../IW3P/.../multi_page.pdf (accessed December 25, 2012).

[48]Catherine Guirkinger, Risk and the Persistence of Informal Credit in Rural Peru, April 2005 http://agecon.ucdavis.edu/people/grad_students/papers/guirkingerlacea.pdf (accessed May 11th , 2013) (This research was assisted by a fellowship from the International Dissertation Field Research Fellow ship Program of the Social Science Research Council with funds provided by the Andrew W. Mellon Foundation).

[49]Waiter Schaefer – Kehnert, Jhon D.Von Piodike,*Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.4.

farmer both for crop and non-crop activities. While referring to the same issues, Tilakaratna rightly states,

> "Loans from informal sources are in general inadequate in scope for development purposes, being often only for short-term purposes and rarely for capital assets, usually for traditional rather than new or innovative activities, and mostly for survival needs rather than for developmental needs".[50]

Other researchers like Sisay Yehuala have the same view regarding the informal credit system.[51] Having such nature, the informal credit system loses its foundation for being applied in the agriculture sector. These scholars also object to the repayment mechanism of such loans by saying, "The conditions of repayment are often not specified at all or are so imprecise that the line between loans and gifts is blurred".[52] It is clear then that if the repayment issues are not properly addressed at the initial stages of the contract, then such a state may lead to very serious consequences where the farmer intentionally defaults and the lender has knowledge of the same. The situation may lead to worse consequences in the case where the creditor and debtor belong to the same family (as often the informal credit loan is secured between relatives and friends).

Some researchers centralized their work on the issue of high interest rates charged by the moneylenders in informal credit transactions. In their view, the skilled moneylenders charge high interest rates resulting in problems particularly for the small farmers in the rural areas of developing countries. In the case where the formal credit facility is not accessible, such interest

---

[50]S. Tilakaratna, *Credit Schemes for the Rural Poor: Some Conclusions and Lessons from Practice, Issues in Development*,Discussion Paper9, Development and Technical Cooperation Department International Labour Office Geneva, International Labour Organization 1996, ISBN 92-2-110101-0,p.3.

[51]Sisay Yehuala, *Determinants of Small Older Farmers Access to Formal Credit: The Case of Metema Woreda, North Gondar, Ethiopia*, April 2008, Haramaya University,p.18(A Thesis Submitted to the Faculty of the Agriculture Department of Rural Development and Agricultural Extension School of Graduate Studies Haramaya University).

[52]Waiter Schaefer – Kehnert, Jhon D.Von Piodike,*Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.4.

rates become good tools for the exploitation of the situation.[53] Some empirical research shows that the case of Pakistan is not different when it comes to this situation.[54] The intellectual work of Rakesh Mohan indicates the same observation after studying the agriculture credit system in India.[55] He proposes that an effective legislation should be made against such malpractice of moneylenders.

Other writers like Manojit Bhattacharjee and Meenakshi Rajeev advocate that such rates of interest do not exist homogeneously across the informal markets but instead fluctuate from lender to lender and from developed to less developed region.[56] They argue that in less developed informal credit markets there are few moneylenders who have full information about the borrowers. The borrowers, in these circumstances, have no other option but to resort to such moneylenders for the provision of loans at high interest rates. In other words, the lack of competition among the moneylenders, naturally build monopolized environments. The case of a more developed informal credit market, however, is not possible due to the existence of a large number of money lenders which increases the options for the availing of credit from multiple sources. Some experts explain the exploitive nature of informal credit through a different slant. In their view; moneylenders generally provide loan capability to the farmers with a condition that they will sell their outputs at the end of the harvesting cycle.[57] In most cases such a price is

---

[53]Adam B. Elhiraika, Sayed A. Ahmed,*Agricultural Credit Under Economic Liberalization and Islamization in Sudan*, The African Economic Research Consortium, AERC Research Paper 79, African Economic Research Consortium, Nairobi March 1998,p.10.

[54]Mir Kalan Shah, Humayun Khan, Jehanzeb ,Zalakat Khan, *Impact of Agricultural Credit on Farm Productivity and Income of Farmers in Mountainous Agriculture in Northern Pakistan: A Case Study of Selected Villages in District Chitral*, Sarhad J. Agric. vol.24, no.4, 2008.

[55]Rakesh Mohan, *Agricultural Credit in India: Status, Issues and Future Agenda*, Reserve Bank of India Bulletin 2004,p.994, http:// rakeshmohan.com/docs/AgricreditBulletin.pdf (accessed May 18th , 2013)(Lecture delivered by Dr. Rakesh Mohan,the then Deputy Governor, Reserve Bank of India on February 5, 2004 at the 17th National Conference of Agricultural Marketing, Indian Society of Agricultural Marketing, Hyderabad. He isgrateful to Dr.Y.S.P. Thorat, then Executive Director, Asha P. Kannan, A. Prasad, Partha Ray, T. Gopinath and ArunVishnu Kumar of the Reserve Bank of India for their assistance).

[56]Manojit Bhattacharjee, Meenakshi Rajeev,*Interest Rate Formation in Informal Credit Markets in India: Does Level of Development Matter*?, BWPI Working Paper 126, September 2010,p.3.

[57]Mir Kalan Shah, Humayun Khan, Jehanzeb,Zalakat Khan, *Impact of Agricultural Credit on Farm Productivity and Income of Farmers in Mountainous Agriculture in Northern Pakistan: A Case Study of Selected Villages in District Chitral*, Sarhad J. Agric. vol.24, no.4, 2008.

comparatively less than the price for the same commodity in the local market. In these experts' view, the lenders of informal credit enjoy two benefits from a single transaction i.e. charging higher interest rates and purchasing the farmers' yield at a price lower than the market price for the same. These experts strongly recommend the concerned governments to provide institutional agricultural finance through commercial banks, specialized agricultural banks, and other financial institutions under the supervision of respective central banks. Tilakaratna, an expert on the rural credit system, has the same view stating,

> Credit provision by moneylenders often involves other obligations such as to buy inputs or consumer goods, or to sell the produce or labor thereby creating opportunities for the lender to impose unfavorable terms of exchange on the borrower. There is often an overlapping of personae of money-lenders, landlords, employers, produce dealers and traders; and in such situations, it would be possible to tie credit supply to operations in produce and labour markets so that all major economic transactions of the borrower operate in favor of the lender.[58]

Due to the reasons noted above and others, moneylenders are sometimes rightly considered an anti-social institution.[59] They do not contribute towards society via the constructive lines rather they exploit the compelling situation faced by the farmers due to the shortage of liquidity particularly in the beginning of a season. Some of the Indian researchers have the same analysis regarding the money lenders in the rural areas of their country.[60] A profound study of various research works on informal agricultural finance exposes that such exploitation is due to the lack of proper education and the low literacy ratio in the farmers' community. A majority of the farmers, particularly those who live in rural areas are illiterate

---

[58]S. Tilakaratna, *Credit Schemes for the Rural Poor: Some Conclusions and Lessons from Practice, Issues in Development*,Discussion Paper9, Development and Technical Cooperation Department, International Labour Office Geneva, International Labour Organization 1996, ISBN 92-2-110101-0, p.3.

[59]P. D. Jeromi, *Regulation of Informal Financial Institutions: A Study of Money Lenders in Kerala*, Reserve Bank of India Occasional Papers, vol. 28, no. 1, Summer 2007.

[60]Y. V. Reddy, *Future of Rural Banking*, (Prof. G. Ram Reddy Third Endowment Lecture by Dr. Y.V.Reddy, Deputy Governor, Reserve Bank of India, at Potti Sreeramulu Telugu University Auditorium Public Gardens, Hyderabad, on December 4, 1999, p.48.

and uninformed and, consequently, not in a position to negotiate the loan transaction with the moneylenders in such a way to get the best possible benefits. This situation may continue to grow for another generation until education is required by all. It is because of this reason the exploitive nature of informal markets is found to be more prevalent in tribal or less developed areas[61] in a comparison to those villages where the education rate extends to a reasonable figure.

2.1.2 Literature Review of Formal Agriculture Finance

Due to the inherent defects in informal agricultural finance like short terms, small amounts, and the exploitive nature of the system, experts of the field are trying to provide alternate solutions in order to handle all of these issues wisely. They long to introduce a new system of agricultural credit that is characterized uniquely by its well-built nature, well organized structure and composition, obvious aims and objectives, ease in procedure and documentation, and flexibility in repayments. By the introduction of such a new credit system, they will have a variety of aims in order to augment growth of agricultural productions. These aims include provision of basic agricultural inputs, introduction of new agricultural technology, enhancement of technical efficiencies, increase in agricultural production etc.

The achievement of all these goals compelled the scholars of the field to start a tidy theoretical work on the formal agricultural credit system. Nevertheless, in the beginning such work remained introductory covering all issues related to the provision of credit service in a short and comprehensive way. They evaded going into the details of various issues either deliberately or due to the newness of the field as many dimensions were not understood. The work of these researchers was, however, of great importance as it lined a pathway for a new revolution in the field of agricultural finance, which, consequently, led to the development of the agriculture sector. In the beginning, these early scholars focused on the question of how to provide financing for local farming. In understanding this connection, they pointed out basic needs of crop and non-crop sectors, followed by the hypothetical discussion of how to fulfill all these needs through the formal agricultural credit system and ended with practical models. The defects mentioned by other scholars regarding the informal credit system were removed while its major

---

[61] Ibid,p.50

benefits were incorporated in the new proposed formal credit system. In this way, an attempt was made to create a new perfect system, feasible both for farmers and financial institutions. They also gave special emphasis in their proposed scheme to the development of local farming in rural areas as majority of farmers, especially in developing and underdeveloped countries live in rural areas.[62]

The research work in this field was initiated by individual investigators rather than institutional or organizational research teams. This meant that the imperfections of the informal credit system were felt by each and every expert of the early agricultural research and they made their contributions for the introduction of a new credit system. In this regard, some remarkable works were completed by these experts in the twentieth century. Walter Schaefer-Kehnert and John D. Von Pischke's work is cited as an example.[63] They thoroughly discussed the conventional credit policy role and objectives, the credit delivery system and its problems, the nature of non-institutional credit, institutional agricultural credit, various methods for the determination of credit worthiness, controlling manner of credit use, viability of agricultural credit for farmers and financial institutions, credit coordination, methods for the regulation of interest rates, and the mechanism for repayment. The work of such scholars was very ample covering all issues related to agricultural credit with minute detail. In addition, the issue of high interest rates, high transactional costs, and agricultural subsidies are also critically analyzed. The peculiar nature of this work was that it discussed the agricultural credit in a very universal sense with no specific concentration on a particular country. This fact amplified the viability of the work for the development of the agricultural sector in all developing countries and also provided an opportunity to make agricultural credit policies in the light of observations found in the work.

---

[62]It is a matter of fact that majority of farmers in developing countries were living in rural areas. For instance in case of Pakistan 62% of the country's population was living in the rural areas and directly or indirectly allied with agriculture as their livelihood(Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan, Ministry of Finance, Chapt.2,p.13. The case of Bangladesh was not different where the population of rural areas reached to 80% of the whole inhabitants (*Strengthening Agricultural Support Services for Small Farmers*), Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004). An empirical research showed the same fact regarding the State of Ghana where half of the population in rural Savannah Zones was extremely poor (WilliamF. Steel,David O. Andah, *Rural and Micro Finance Regulation in Ghana: Implications for Development and Performance of the Industry*, *Africa Region*, Working Paper Series no.49 June 2003.

[63]Waiter Schaefer – Kehnert, Jhon D.Von Piodike,*Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.4.

However, the work also lodged some drawbacks in its various approaches. For example, it supported and, even, recommended high interest rates for agriculture credit, particularly when the borrowers were small farmers,

> Paradoxical as it may sound; small farmers clearly have better prospects of getting credit when interest rates are high. High rates limit the big farmers' investment opportunities and restrict their demand for credit. Many small farmers are accustomed to paying moneylender rates that are far higher than the highest bank interest rates.

Richard L. Meyer concurred with this view when he cited Gonzalez-Vega in his work, "Low interest rates created an excess demand for credit, and rationing logically tended to favor richer and more politically powerful farmers".[64] This observation was not based on logic nor was it based on the fact that the majority of small farmers belonged to the lower class and was not in a position to pay high interest rates. Some scholars, therefore, had an unlikely approach in their research advocating for lower interest rates in agricultural credit largely for the local farming in rural areas.[65]

The accessibility of formal credit institutions has remained difficult for farmers because they have not been in a position to avail credit provided by those financial institutions. Some studies revealed that the majority of farmers had no access to formal credit.[66] This not only deprived the farmers from benefiting from the credit programs of various financial institutions but it also blocked the way for an introduction of new technology into the agricultural sector. Khalid S. Mohamed and Andrew E. Temu have

---

[64]Richard L. Meyer,*Subsidies as an Instrument in Agriculture Finance: A Review*, Joint Discussion Paper – Issue,German Federal Ministry Of Economic Cooperation And Development (Bmz), Food And Agriculture Organization Of The United Nations (FAO), German Agency For International Cooperation (Giz), International Fund For Agriculture Development (Ifad), The World Bank, And United Nations Capital Development Fund (Uncdf), chapter 5, p.11.

[65]See for example the work of Mir Kalan Shah, Humayun Khan, Jehanzeb ,Zalakat Khan, *Impact of Agricultural Credit on Farm Productivity and Income of Farmers in Mountainous Agriculture in Northern Pakistan: A Case Study of Selected Villages in District Chitral*, Sarhad J. Agric. vol.24, no.4, 2008.

[66]Khalid S. Mohamed and Andrew E. Temu, Bergamo, *Access To Credit and its Effect on the Adoption of Agricultural Technologies: The Case of Zanzibar*, African Review of Money Finance and Banking, (2008), Research Center on International Cooperation of the University of Bergamo, pp. 45-89, http://www.jstor.org/stable/41410533 . (accessedJuly15th , 2013).

reached the same conclusion in their empirical research work.[67] They further exposed a variety of reasons and factors responsible for the lack of farmers' access to such credit including the number of access to credit, the value of productive assets owned, household income, and the possibility of keeping live stock. Shankariah Chamala and Shah M. Alamgir Hossain also found comparable findings in their research.[68] The academic work of Khalid S. Mohamed and Andrew E. Temu and other similar works proved vital for financial institutions by incorporating it at the time of framing credit policies and opening their local branches in the easiest and most accessible locations. In recent decades many financial institutions opened their branches in remote areas. For instance, various financial institutions in India opened over 35,000 branches in rural areas.[69] However, some financial institutions were still reluctant to open their branches in remote areas of a country. There were many reasons for this sort of institutional resistance as discussed by some of the scholars in their collective research projects. Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, and others[70] found that distance, isolated and dispersed population, and poor road and energy infrastructure made it extremely difficult and expensive for financial institutions to open branches in the rural areas and to serve and monitor clients. A research report conducted under the main guidance and supervision of Peer Stein (IFC) and Susanne Dorasil (BMZ) had the same observation.[71]

---

[67]Ibid,p.45

[68] Shankariah Chamala and Shah M. Alamgir Hossain, *Adoption of Formal Agricultural Credit by Opinion Leaders and other Farmers in Differentially Developed Villages of Bangladesh*, Savings and Development, Vol. 20, No. 4 (1996), pp. 431-445.

[69]Rewa Misra, *Primary Agricultural Credit Society Linkage, India: The Best Remote Rural Self-Help Groups Can Do?, (Case Study)*, the Coady International Institute, June 2008,www.coady.stfx.ca/tinroom/assets/file/ford/.../Coady_IndiaPAC_Final.pd (accessed 5th July ,2011.

[70]Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, *Creating Access to Agricultural Finance Based on a Horizontal Study of Cambodia*, Mali, Senegal, Tanzania,Thailand and Tunisia, July 2012,p.24,capacity4dev.ec.europa.eu/.../creating_access_to_agricultural_finance.*pd*(accessed July 16, 2013)(The A Savoir collection was created in 2010 by AFD's Research Department and gathers either literature reviews or existing knowledge on issues that present an operational interest. Publications in this collection contain contributions based on research and feedback from researchers and field operators from AFD or its partners and are designed to be working tools. They target a public of professionals that are either specialists on the topic or the geographical area concerned).

[71]*Innovative Agricultural SME Finance Models*,International Finance Corporation November 2012, p.15, http://www.ifc.org/wps/.../Innovative+Agricultural+SME+Finance+Models.pdf.(accessed june29, 2013).

The experts of agricultural finance developed a variety of models for financing agriculture in their corresponding countries. Some factors are kept strictly in the development of such models such as the economic condition of the farmers, their place of residence (rural or urban), the collaterals they could offer to financial institutions as a security, the political environment, weather conditions, the size of the property, etc. These models will be discussed in more detail in the following section.

A very well reputed agricultural financing model was presented by Robert Peck Christen and Douglas Pearce in their work.[72] Their intention was to provide financial services to poor and rural farming households. The model was considered exceptional for being a mixture of various products and financing techniques like traditional agricultural finance and other approaches already experienced for the development of agricultural sector (like leasing, area based insurance, use of technology and existing infrastructure, and contracts with processors, etc). The success of the model was due to ten main features instilled by such scholars in its structure and configuration.[73] The model, however, was designed for micro-agricultural finance and was, consequently, limited because macro agricultural financing in those days could play a vital role in the development of the agricultural sector. Additionally, the work was mainly related to the introduction of a new model for rural agricultural finance and did not accommodate the urban agricultural finance in its discussion.

---

[72]Peck Christen andDouglas Pearce, *Managing Risks and Designing Products for Agricultural Microfinance, Features of an Emerging Model,*11th paper,(Printed at IFAD in 2006 with the support of Finnish Supplementary Funds) August 2005, http://www.ifad.org/ruralfinance/pub/risks.pdf (accessed August 17, 2013)…Occasional Paper 11, issued on August 2005 by the Consultative Groupto Assist the Poor (CGAP), is being re-issued as part of a series ofpublications to update IFAD's Rural Finance Decision Tools. Occasional
Paper 11 results from a research project funded by IFAD on emerginglessons in agricultural microfinance. Based on desk reviews, site visits andstakeholder consultations, CGAP identified institutions actively engagedin agricultural finance that showed the potential to achieve scale andsustainability. This paper reviews cross-cuttingfeatures that characterize successful agricultural microfinance portfolios.

[73]These ten characteristics were (1)Repayments are not linked with loan used ,(2) character based lending techniques are combined with technical criteria for selection of borrowers ,(3) saving mechanisms are provided ,(4)portfolio risk is highly diversified ,(5) loan terms and conditions are adjusted to accommodate cyclical cash flows and bulky investments (6) contractual arrangements reduce price risk ,enhance production quality and help guarantee payment,(7) financial services delivery piggybacks on existing institutional infrastructure or is extended using technology ,(8)membership based organization can facilitate rural access to financial services and be viable in remote areas ,(9) area based index insurance can protect against the risks of agricultural lending ,(10) to succeed ,agricultural finance must be insulated from political interference.

Another important model was presented by Michael Winn, Calvin Miller and Ivana Gegenbauer.[74] Their work was significant in the sense that it brought the concept of Structured Finance (SF)[75] instrument's into agriculture finance for the very first time. In their view, the value of SF techniques for agricultural finance and agribusiness had been hidden in the fact that the majority of farmers were not in a position to provide the required collaterals to financial institutions and were, accordingly, mostly deprived from financial assistance. However, in the view of other agricultural finance experts, SF could not be considered an appropriate channel for financing agriculture as it was offered to borrowers needing a vast injection of capital. Such a technique had no importance for agriculture, as it required comparatively less capital for its needs. Similarly, the work of such scholars was limited to the application of the SF model in Eastern Europe and Central Asia and was not seen as applicable for other parts of the world with the same capacity.

Betty Kibaara and James Nyoro did a critical study of various emerging models in agriculture finance.[76] Their 2007 study was performed in order to comparatively examine the existing models used for financing agriculture. They discussed each of the emerging models in detail focusing on the basic nature of the model, its main characteristics, structure and composition, functions, past institutional history, reasons for success and failure, etc. The soundness of such analytical work was indisputable as the research was based on reliable data collected from the main stakeholders belonging to six various agro ecological zones. On the other hand, the work also opened the doors for many deficiencies. For instance, the work was

---

[74]Michael Winn, Calvin Miller, Ivana Gegenbauer,*TheUse of Structured Finance Instrumentsin Agriculture in Eastern Europe and Central Asia*,Agricultural Management, Marketing and Finance Service (AGSF)Rural Infrastructure and Agro-Industries Division ,Food And Agriculture Organization of the United Nations Rome, 2009http://www.ruralfinance.org/.../1255015522845_WD_26_ECA_v4_per_web.pdf(accessed August 17, 2013).

[75]Structured Finance is a service offered by financial institutions to companies having unique and huge financial needs. The SF usually involves very complex financial transactions and that is why the service is not preferable for ordinary customers of financial institutions. The concept has its place in the industry since 1980s and its typical examples are collateralized bond obligation (CBOs), collateralized debt obligation (CDOs), syndicated loan etc.

[76]Betty Kibaara and James Nyoro, *Expanding the Agricultural Finance Frontier: A Kenyan Case*, AAAE Conference Proceedings (2007) 287-290, http://ageconsearch.umn.edu/bitstream/52109/2/Kibaara.pdf(accessed August 22, 2013).

solely performed from the perspective of Kenyan agriculture and, therefore, its findings could not be applied to agriculture sectors of other countries. In addition, the existing models were critically analyzed from all slants except the policies instilled by the financial institutions in all these models. This fact curtailed the value of the work because no new dimensions were recommended for financial institutions in order to structure future financing models.

Another celebrated work on the issue of agricultural models was presented by Calvin Miller.[77] The research was very unusual as it introduced not only microfinance models for agriculture but also provided a space for the discussion of microfinance products for the same field.[78] So he disputed the various existing models[79] used by the financial institutions for financing agriculture and argued that those products were not suitable to crop agriculture. In his view, while financing agricultural crops, more emphasis should be given to the concepts of cash flow and the conditions rather than other factors like capacity, collaterals or capital, and character. However, the work faced deficiency in the sense that it did not discuss or develop models for other major sectors of agriculture like livestock, poultry farming, dairy farming, horticulture, fish farming etc. The reason is obvious for this limitation as these sectors required a great deal of money and the author mainly focused his work on micro credit facility which could be effectively employed for the local farming sector of agriculture both in crop and non-crop activities.

---

[77]Calvin Miller, *Microcredit and Crop Agriculture: New Approaches, Technologies and other Innovations to Address Food Insecurity Among the Poor*, 201, Global Microcredit Summit Commissioned Workshop Paper November 14-17, 2011 – Valladolid, Spain, http://www.globalmicrocreditsummit2011.org/.../C_%20%20Miller%20-%20(accessed August 17, 2013)

[78]These microfinance products include (1) Bill discounting and factoring for micro and small agro enterprises ,(2) Forward contracting and futures,(3) Micro-Leasing,(4) Warehouse receipts and micro warrant finance ,(5) Micro insurance,(6) Guaranties etc.

[79]Calvin Miller pointed out some weaknesses in the existing products. For example such products involve high interest rate, mostly given for short terms, small loan size which is not mostly sufficient for meeting the financing requirements both for seeds and equipments, limited financial services with one or few types of loans ,restricted geographical coverage, weekly installments or monthly loan repayments, group lending with limited flexibility etc(Calvin Miller, *Microcredit and Crop Agriculture: New Approaches, Technologies and other Innovations to Address Food Insecurity Among the Poor*, 201, Global Microcredit Summit Commissioned Workshop Paper November 14-17, 2011 – Valladolid, Spain, p.8).

Another notable area of research related to agricultural models was conducted by Tushar Pandey.[80] He maintained that the contract farming model[81] was the most appropriate method for financing agriculture. His work was very comprehensive in nature as it thoroughly covered all the essential dimensions of the issue. Its comprehensiveness was apparent as Pandey started his work with the definition of the contract farming and ended with a presentation of an improved model for financial institutions, small holders, intermediaries, private players, hi-tech agribusiness farms, etc. Despite of the worth Pandey's work had for agricultural finance, it also faced deficiencies in terms of its nature and composition. For instance, the involvement of big corporations was not an adequate approach for financing the lower class of farmers as they required very simple financing for the fulfillment of their crop and non-crop agricultural needs. By involving various mediators in the process it would simply increase the transactional cost and, consequently, that burden would pass on to the farmers. Moreover, the work both at the theoretical and practical level was purely related to the Indian agricultural sector and, hence, the developed model was a unique one and could not be generalized in terms of its application for the agricultural sector of other countries.

A well renowned work on the model of contract farming was conducted by Martin Prowse.[82] His broad research covered all the related issues of the model in detail beginning, for instance, with the historical background of contract farming followed by the limits of its use in

---

[80]Tushar Pandey, *Contracting and Agricultural Finance for Small Holders- Hi-Tech Farming and a Case for Public Private Partnerships*, http://www.ncap.res.in/contract_%20farming/.../13.1%20Tushar%20Pandey.p(accessed August 17, 2013).

[81]Contracting farming can be structured on many ways depending on the nature of the crop for which the finance is needed, the objectives having by the sponsor and his resources and the work experience of the farmer who resorts to financial institutions for the fulfillment of his financial needs .such model in broad sense can be divided into five categories (1) The Centralized Model (where the sponsor purchases the crops from the farmer and after the processing the same sell it in the local market),(2) The Nucleus Model(it is basically a molded type of centralized model where the sponsor owns and manages the estate plantation which is usually very close to processing plant),(3) The Multipartite Model (which usually involves statutory bodies and private companies which jointly contract with the farmers),(4) The Informal Model (it usually involves those cases where small companies and entrepreneurs informally contract with the farmers mostly on seasonal basis),(5) The intermediary Model (where large food processing companies and fresh vegetable entrepreneurs purchases crops from farmers directly or from other individuals who purchases the same from the farmers. See for further details Types of contract farming, FAO Agricultural Services Bulletin2001, http://www.fao.org/DOCREP/004/Y0937E/Y0937E00.HTM (accessed August 25, 2013).

[82]Martin Prowse, *Contract Farming in Developing Countries - A Review*, Savoir collection , 2010 , AFD's Research Department, www.afd.fr/webdav/shared/PUBLICATIONS/.../12-VA-A-Savoir.pdf(accessed August 29 , 2013).

the United States and other countries' agriculture. In addition, he discussed the expected threats that could become obstacles to the successfulness of the contract farming arrangements and also presented a variety of solutions to reduce those threats. He presented a pragmatic approach to the concept as compared to other scholars and made it clear that instead of having many benefits, the contract farming method had a number of risks for small producers.[83] However, the model presented in the work was not suitable for developing and underdeveloped countries as the contract farming, and its basic features and characteristics, were discussed with a special reference to advanced and developed countries like the United States and Europe. In addition, the work was concentrated on other sectors of agriculture like livestock, poultry farming, dairy farming, and horticulture and placed less emphasis on local farming which is the sector of agriculture that the majority of farmers are related.

The models developed by various researchers (some of which are mentioned above) were seen as very constructive for the development of agricultural financing both for crop and non-crop sectors. The financial institutions launched their agricultural financing in light of the directions proposed in these various models. While doing so, however, they operated only those models which were deemed fit to their own business environments and objectives without considering the agriculture needs of farmers in the concerned area where the implementation of the model was proposed. Because of this disposition, many problems were created like charging of high interest rate, demand for high collaterals, concentration on rich farmers in terms of financing, complex procedure etc

All these problems were suspected early on by the experts of agricultural finance and they began working toward their solutions. They first attended to the matter of high interest rates. The

---

[83]In the view of Martin Prowse these five risks can be categorized in five i.e. (1) contract farming can lead to loss of autonomy and control over farm enterprise and a form of dependency on the contracting firm; (2) there is a substantial risk if inappropriate technology is used by the farmer ;(3) the absolute nature of the firm's right to purchase can possibly depress the producer price or it may lead to may lead to the situation where the payment is delayed or it is paid in partial ;(4) the contract of farming may be verbal or it may be in the written form as permitted by law .and even in the latter shape the conditions can be exploited against the small holders ;(5) the intra household distribution can be made in such a way that may put the women rights in danger(ibid,p.68).

rationale was that all other problems were allied to this issue in one way or another and, therefore, its solution was considered at priority by these scholars.[84]

Mare Hudson's work[85] examines the issue of interest in microfinance particularly in the context of the lower class of the society.[86] In his view, the issue of high interest rates is not only discussed and challenged within the financial institutions but such debate is also going on in civil society and at the political level. He adds that the taking of high interest rates is considered unethical and, hence, many MFIs institutions have closed in India for being accused of usurious interest rates and unethical recovery practices. While citing an example from the work of Feuillet, Hudson says that nearly fifty branches of two financial institutions in India were closed on the same grounds. He goes on to present four ways to determine fair interest rates in micro financing.[87]

---

[84]For example in the view Johan F. M. Swinnen and Hamish R. Gow the high interest rates are the main reason due to which famers loose their access to agricultural credit. They add that such high interest rates are due to transition and structural problems. It means that if these two problems are removed then the rate of interests can be easily dropped down. In their view, as ancillary to this main problems there are some other factors responsible for the increase in interest rates i.e. high collaterals , low profitability and etc compelled the financial institutions to consider agricultural as a high risk consumer(Johan F. M. Swinnen and Hamish R. Gow, *Agricultural Credit Problems and Policies During the Transition to a Market Economy in Central and Eastern Europe*, Policy Research Group Working Paper No. 61997,p.2 http://ageconsearch.umn.edu/bitstream/31887/1/prg-wp06.pd(accessed September 22, 2013) ; Dayo Phillip, Ephraim Nkonya, John Pender, and Omobowale Ayoola Oni have the same observation in their work. In their view, the high interest rates and high collaterals are the major reason due to which a small farmer particularly that of rural areas is not in position to have access to agricultural credit provided by the financial institutions. In addition, such loans are often provided for short terms with fixed repaymentperiods.They argue that such loans are structured in such a way which is not suitable for annual cropping or livestock production.(Dayo Phillip, Ephraim Nkonya, John Pender, Omobowale Ayoola Oni ,*Constraints to Increasing Agricultural Productivity in Nigeria,* Nigeria Strategy Support Program Brief No. 4,International Food Policy Research Institute, http://www.ifpri.org/sites/default/files/publications/nsspbrief04.pd(accessed September 22, 2013).

[85]Marek Hudon is Professor at the Solvay Brussels School of Economics and Management (SBS-EM), Université Libre de Bruxelles (ULB), Belgium. He is also Co-Director of the Centre for European Research in Microfinance (CERMi), and Co-Director of the Centre d'Etudes Economiques et Sociales de l' Environnement (CEESE). He has initiated and is still Scientific Coordinator of the European Microfinance Programme (EMP). He has conducted research in India, Kenya, Mali, Morocco, Vietnam and the Democratic Republic of Congo.His research mainly focuses on microfinance, ethics, sustainable development, and social entrepreneurship.

[86] Marek Hudon, *Fair Interest Rates When Lending to the Poor*,(2007),FNRS Research Fellow Solvay Business School, Université Libre de Bruxelles, Ethics and Economics, 5, 1, pp. 1-8, www.aderse.org/.../Fair%20interest%20rates%20when%20lending%20to.(accessed September 30, 2013).

[87]These approaches are; (1) Deontological approach which is the oldest one. This theory prohibits the charging of interest or limits the same on theological basis. For example the Council of Nice has condemned interest rates in 325

The issue of high interest rates is also discussed by Rashid Metal and S.P. Sing in their work related to aromatic plants.[88] They explain that high interest rates are the major constraint faced by the farmers in cultivation of aromatic plants[89] in the state of Uttarakhand (a state in the Northern part of India). Their research confirms that nearly 72% of the farmers consider high interest rate as a hurdle in the cultivation of aromatic plants.[90] The work, however, does not deal with the issue of high interest rates particularly in the context of local farming and other major sectors of agriculture like livestock, poultry farming, dairy farming, fish farming, etc.

The issue of high interest rates in agriculture is also discussed by Sisay Yehuala in his study.[91] His approach, however, is completely different as compared to other scholars. For example he does not follow the traditional method for describing high interest rates instead he has drawn observations that touch ground realities and are based on group interviews conducted with farmers. He found that the majority of farmers do not have any information regarding the rate of interest and they have a very different perception to the rate of interest charged by the financial institutions. They actually consider the rate of interest a reasonable and justifiable because loans are provided and collected by the financial institutions. In his view high interest

---

AD, (Similarly Islam prohibits the charging of interest rates as prohibited activity). Aristotle has the same opinion regarding interest………. (2) The second approach is based on the fairness of interest rates which can be determined on the fact that whether a client cost over the interest rate is equal to that of financial institution in case of the latter absence…………..(3) The third approach is related to the ethical dimensions which focuses on the demand for credit .According to this approach if the repayment ratio is high and the demanding for credit is increasing then it shows fairness of the interest rates ………(4) The fourth approach is related to the procedure which means that rules of the market should be equally applicable to all customers without any sort of discrimination…………..(Marek Hudon, *Fair Interest Rates When Lending to the Poor*,(2007),FNRS Research Fellow Solvay Business School, Université Libre de Bruxelles, Ethics and Economics, 5, 1, pp. 3-6, www.aderse.org/.../Fair%20interest%20rates%20when%20lending%20to.(accessed September 30, 2013).

[88]Mittal, Rashi, and S. P. Singh. "Shifting *from Agriculture to Agribusiness: The Case Of Aromatic Plants*." Agricultural Economics Research Review 20, no. 2007 (2007), vol.4,pp 541-550.

[89]Aromatic plants are those which have a distinct fragrance or order. These plants have been used for thousand years for various purposes ranging from medicinal to religious, from protection against spirits to culinary delights etc. These plants include lemon grass, vanilla, rosemary, oregano etc ………. See for details http://www.bio.georgiasouthern.edu/bio-home/leege/.../aromatics/aromatic.htm (accessed October 14, 2013).

[90]Mittal, Rashi, and S. P. Singh. "Shifting *from Agriculture to Agribusiness: The Case Of Aromatic Plants*." Agricultural Economics Research Review 20, no. 2007 (2007), vol.4,pp 541-550.

[91]Sisay Yehuala, *Determinants of Smallholder Farmers Access to Formal Credit: The Case of Metema Woreda, North Gondar, Ethiopia*, (M.Sc. Thesis), April, 2008 Haramaya University, Department of Rural Developmen and Agricultural Extension School of Graduate Studieshttp://cgspace.cgiar.org/bitstream/handle/.../Thesis_YehualaDeterminants.pdf? (accessedOctober, 2013).

rate does not create problems for the farmers and, if it is used for the purposes intended from the credit program, it will become very profitable and sufficient to cover the rate of interest in the end. He argues, while referring to the work of Hossain, that high interest rates prevent the exploitive use of credit programs by those who are not intended to receive benefit from such loans. There are other scholars with the same view.[92] In his empirical research, Yehuala has shown through his collected data that a high interest rate is not a hurdle in the way of farmers in getting access to agricultural loans. Approximately 92% of the lower class of farmers does not consider high interest rates a serious issue for them (see Table 2).

Wealth status/sex	Yes		No		X^2-value	Total	
	N	Per cent	N	Per cent		N	Per cent
Rich	1	14.3	6	85.7	3.293	7	5.4
Medium rich	2	9.5	19	90.5		21	16.1
Poor	4	8.0	46	92.0		50	38.5
Very poor	4	7.7	48	92.3		52	40.0
Male	8	8.1	91	91.9	0.005	99	76.2
Female	3	14.3	28	85.7		31	23.8

Table 1: [93] Farmer's perception of the interest rates charged by the cooperatives

Source:http://cgspace.cgiar.org/bitstream/handle/.../Thesis_YehualaDeterminants.pdf

---

[92]For example in the view of Walter Schaefer-Kehnert and John D. Von Pischke, the small farmers have enhanced prospects when the financial institutions charge them with high interest rates. They further add that high interest rates keep the big farmers away from getting loan. Many small farmers become customary to pay high interest rates to the money lenders .Sometime these interest rates are more than the highest interest rates charged by a bank on the equivalent amount. In their view, such rates of interest can be further cut down by taking some measures i.e. through the simplification of loan application of loan procedure, reduction of queuing time, provision of timely credit, group credit arrangements, etc (Walter Schaefer – Kehnert and Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280, 1982.p.4.

[93]Sisay Yehuala, *Determinants of Smallholder Farmers Access to Formal Credit: The Case of Metema Woreda, North Gondar, Ethiopia*, (M.Sc. Thesis), April, 2008 Haramaya University, Department of Rural Developmen and Agricultural Extension School of Graduate Studieshttp://cgspace.cgiar.org/bitstream/handle/.../Thesis_YehualaDeterminants.pdf? (accessedOctober, 2013).

However, the researcher's assumption seems a bit irrational to think that a lower class farmer, who is not in a position to purchase basic agricultural inputs like seeds, fertilizers, herbicide, weedicides, pesticides, etc, can pay high interest rates. The author's postulation may be appropriate for the lower class of farmers in developed countries where such farmers are having equal financial status to that of upper and middle class farmers of developing and underdeveloped countries. Even in some developed countries where charging of high interest is legally allowed, the conventional financial institutions are also allowed to charge low interest rates.[94] Moreover, the work of the author is purely related to the study of smallholder farmer's access to formal credit in Metema Woreda, North Gondar (a region in Ethiopia) and, hence, the findings cannot be generalized for all regions in the world.

Contrary to Yehuala's findings, Samuel Kwaku Obeng'swork concludes that if the rate of interest is high then it decreases the demand for agricultural loans.[95] In his research with experienced farmers (of Abokobia)[96], he used a questionnaire containing various questions related to the issue of interest i.e. what do you think about the interest rates being charged by the bank? Do the interest rates scarce you from borrowing from the bank? Do you find it tough paying the loans? Does the high interest rate affect your farming? What are some of the effects of the high interest rates on your farming, etc? In his view farmers are required to sell their

---

[94]According to Canadian Agricultural Loan Act (CALA) (Lenders Guideline) "The rate of interest can be either floating or fixed. At any time during the repayment period of a loan, the lender and the borrower may agree to change from a floating interest rate to a fixed interest rate, and vice-versa. Although the CALA provides a maximum rate of interest, lenders may charge interest rates lower than the maximum interest rates indicated below"……….*Canadian Agricultural Loans Act* (CALA) LENDERS' GUIDELINES June, 2009 © Her Majesty the Queen in Right of Canada, 2009 AAFC No. 10094E ISBN No. A22 503/2009E-PDF Cat.No. 978-1-100-131915-9http://www5.agr.gc.ca/resources/prod/doc/prog/cala.../pdf/cala-lcpa_info_e.pdf (accessed October 16, 2013).

[95]Samuel Kwaku Obeng, *Rural Banking in Ghana: It's Impact on Rural Farmers (A Case Study of Abokobi Rural Area)*, Samven's Research and Consultancy Unit, July, 2008http://www.modernghana.com/ghanahome/download.asp?id=102(accessed October16, 2013).

[96]Abokobi, a Christian settlement is located at the foot of the Akwapim Range. It is about seventeen miles from Accra, the capital of Ghana. The route to Abokobi branches off at mile fifteen on the Accra-Aburi road. It is situated in the thick woods on the route used by the Danish Government during the era of the slave trade in the Gold coast. This route served as the main access road from the hinterland to the coastal towns, notably Osu, from where slaves were shipped overseas via the Christiansburg Castle.(http://www.abokobipresby.org/index-3.html(accessed October16, 2013).

whole agricultural yields and even other assets in order to repay the borrowed amount. Many scholars, who are conversant in agriculture finance, state the same findings in their works. For example, Johan F. M. Swinnen and Hamish R. Gow explain the resulting effect of high interest rates[98], "Limited credit and high interest rates often appear as an impediment to agricultural development, inhibiting the acquisition of capital necessary for modern agriculture".[99] Muhammad Khalid Bashir and Muhammad Masood Azeem consider the high interest rate as one of the main constraints to the farmer's access to agricultural credit.[100] (See Table 2)

Sr. #	Constraints	Percentage of Loanees
1	Lengthy / cumbersome bank procedures	61.4
2	High interest rate	77.2
3	Cooperation of banks' staff	45.6
4	Loan is not provided in time	71.9
5	Security Problems	54.4
6	Repayment terms are rigid + too rigid	63.2 (28.1 +35.1)

Table 2: Constraints faced by the farmers needing agricultural credit

Source: Muhammad Khalid Bashir and Muhammad Masood Azeem, Agricultural Credit in Pakistan: Constraints and Options, Pak. j. life soc. sci. (2008), 6(1): 47-49, http:// www.pjlss.edu.pk/sites/default/files/47-49.pdf

While Obeng's work is seen as important in the field, it also has several limitations. Initially, the data collected in the work is limited as only thirty (30) questionnaires are used for the accumulation of information. This small number cannot guarantee validation of any collected data. Also too many questions are asked of the respondents indicating that the questionnaire was divergent putting the accuracy of the results in danger. Finally, the work deals only with the study of rural banking in a particular area (i.e. Abokobi Rural Area). This limitation restricts the general applicability of the work in other agricultural environments.

---

[97]Samuel Kwaku Obeng, *Rural Banking in Ghana: It's Impact on Rural Farmers (A Case Study of Abokobi Rural Area)*, Samven's Research and Consultancy Unit, July, 2008http://www.modernghana.com/ghanahome/download.asp?id=102(accessed October16, 2013).

[98]In the view of Johan F. M. Swinnen and Hamish R. Gow, high interest rates are not due to the exploitation of the financial institutions or money lenders rather they are due to the high default rates or high cost owing to the screening and monitoring of agricultural loans. They consider that such high interest rates are rational and efficient response by lenders to the imperfect information problem of the agricultural sector. Johan F. M. Swinnen and Hamish R. Gow, *Agricultural Credit Problems and Policies During the Transition to a Market Economy in Central And Eastern Europe,* Policy Research Group Working Paper No. 61997,p.4.

[99] Ibid,p.5.

[100]Muhammad Khalid Bashir and Muhammad Masood Azeem,*Agricultural Credit in Pakistan : Constraints and Options*,Pak. j. life soc. sci. (2008), 6(1): 47-49.

Another important study that tackles the concept of high interest rate is that of Kewal Kumar and Atul Gambhir.[101] Their work is mainly related to the concept of agricultural finance in commercial banks; however, they also discuss the issue of high interest rates in much detail. Their work is unusual as they divide all the problems faced by all farmers into three classes[102]. Among these problems, high interest rate is the one that is common and almost faced by all class of farmers. They add that such high interest rates can be reduced to a great extent by employing the following measures:

1. Policy makers must rethink the procedure for securing agricultural loans in order to simplify the process. There are many times when a farmer has applied for a loan in the beginning of a crop's season and only secured it at the end of the same season. In Pakistan, the farmers are seriously facing unnecessary delay in the provision of loans.[103] Therefore, some scholars of the field have suggested the timely provision of loans so that farmers may get the intended benefits from the same. Adebayo K.Dreas, explains from this study of financial institutions and agricultural credit that, "Essentially, the banks should endeavor to prevent unnecessary delay in loan disbursement in order to ensure timely use of the loan by

---

[101]Kewal Kumar and Atul Gambhir, *Financing of Agriculture by Commercial banks – Problems Faced by Farmers (An Empirical Study)*, vol.1, issue no.5 http://www.abhinavjournal.com/images/Commerce.../May12/10.pdf(accessed October 16, 2013).

[102] According to Kewal Kumar and Atul Gambhir, the problems which are faced by the marginal and small farmers include high rate of interest on loan, lack of financial knowledge, burdensome processing of getting loans, non cooperation from the banking stop, lack of security and collaterals, fear factor about recovery process etc. Similar problems are faced by the middle class of farmers except the problems related to the lack of security and other collaterals. The upper class of farmers face comparable problems except they always have a complaint that the liquidity provided by the financial institution through agricultural credit scheme ids not sufficient to fulfill all their agricultural requirements ……..Kewal Kumar and Atul Gambhir, *Financing of Agriculture by Commercial banks – Problems Faced by Farmers (An Empirical Study)*, vol.1, issue no.5 http://www.abhinavjournal.com/images/Commerce.../May12/10.pdf(accessed October 16, 2013).

[103]A recent article published in The Dawn News raised the same issue about agricultural loans. According to the corresponding reporter, the local farmers made a compliant that public sector banks, including Zarai Taraqiati bank (which is specialized bank for the development of agricultural sector in Pakistan), did not provide agricultural loans oat appropriate time (the time when a farmer needed money in the beginning of a season to buy basic agricultural inputs like seeds, fertilizers, pesticides, weedicides, herbicides, insecticides etc) and they make unnecessary delay in this regard. (The report was solely based on farmers' viewpoint regarding the agricultural loans and it clearly showed level of the government and its financial institutions' interest in the productivity of agricultural sector particularly that of rural areas *)………Delay in bank loans worries farmers*, The Dawn , Published 2011-05-05 22:11:56 http:// beta.dawn.com/news/626412/delay-in-bank-loans-worries-farmers(accessed October 17, 2013).

the farmers[104]. As a result of this unnecessary delay, the majority of farmers have more inclination towards informal sources as compared to formal sources (like banks and other financial institutions) for agricultural credit. The collective research conducted by Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, and others reveals the same information.[105] Muhammad Khalid Bashir and Muhammad Masood Azeem have the same opinion in their research regarding financial institutions' procedures for farmers securing credit.[106]

2. Interest rates for small and marginal farmers should be reduced to a great extent because the majority of farmers belong to the lower class and are not in a position to pay high interest. Some countries, therefore, follow the low level interest policy for agriculture as compared to other sectors. Some studies reveal this exception. For example in Osogbo, Osun State, Nigeria, the majority of the commercial banks are charging less interest rate on agricultural loans as compared the non-agricultural sector.[107] In 1979, the government of Pakistan began the mark up free credit scheme in order to provide short term free interest

---

[104]Adedapo, K. D. *"Analysis of Default Risk of Agricultural Loan by Some Selected Commercial Banks in Osogbo, Osun State, Nigeri,* International Journal of Applied Agriculture and Apiculture Research, vol 4, no. 1&2 (2012).

[105]Based on the collective research conducted by Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms etc "the timing in harvest financing is critical. The right financing at the right time means greater efficiency, improved product quality and increased incomes. This is the attraction of microfinance, which is able to respond more quickly than banks could, in spite of the high interest rates charged. This is also the reason why moneylenders continue to fulfil a need: they can respond instantaneously, and the speed of their service delivery often compensates for the very high loan costs and often harsh recovery methods"………… Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, *Creating Access to Agricultural Finance Based on a Horizontal study of Cambodia, Mali, Senegal, Tanzania,Thailand and Tunisia*, July 2012,p.24,capacity4dev.ec.europa.eu/.../creating_access_to_agricultural_finance.pd(accessed July 16, 2013)(The Savoir collection was created in 2010 by AFD's Research Department and gathers either literature reviews or existing knowledge on issues that present an operational interest. Publications in this collection contain contributions based on research and feedback from researchers and field operators from AFD or its partners and are designed to be working tools. They target a public of professionals that are either specialists on the topic or the geographical area concerned).

[106]Muhammad Khalid Bashir and Muhammad Masood Azeem,*Agricultural Credit in Pakistan : Constraints and Options*,Pak. j. life soc. sci. (2008), 6(1): 47-49.

[107]Adedapo, K. D. "Analysis of Default Risk of Agricultural Loan by Some Selected Commercial Banks in Osogbo, Osun State, Nigeria." International Journal of Applied Agriculture and Apiculture Research 4, no. 1&2 (2012): 24-29. http:// www.ajol.info › Home › vol 4, no 1&2 (2007) (accessed October 17, 2013).

loans to the small farmers for production purposes.[108] In the 1960s and 1970s the same measures were taken in India.[109]

The previous discussion rationally leads one to inquire about the reasons (hidden and unhidden) why a financial institution is compelled to charge high interest rates on agricultural loans. In order to find the answer and solution to this query, some researchers contributed an unparalleled work in their profound and practical based study. Some of the reasons mentioned are high transactional costs, lack of collaterals, inherited risks in agriculture (like flood, drought, hail storm, earthquake, mudslide, etc.[110]), high chances of delay in repayments, weak farming practices (due to not being in a position to use new agricultural technologies and increase their agricultural yield), remoteness of rural agricultural areas (which increases the banks' risks) and others. Additionally, there are some other universal reasons that increase the rate of interest and these are common in agricultural and non-agricultural credit.[111] However, the most important among these is the high transactional cost on formal loans which induces the customer (including farmers and other customers) to go for informal sources of credit.[112]

---

[108]Muhammad Wasif Siddiqi, Mazhar-ul-Haq, Kishwar Naheed Baluch, Institutional Credit: A Policy Tool for Enhancement of Agricultural Income of Pakistan, International Research Journal of Arts & Humanities (IRJAH) vol. 37 ISSN: 1016-9342,p.158, http:// www.usindh.edu.pk/irjah/.../11.%20Muhammad%20Wasif%20Siddiqi.p(accessed October 18, 2013).

[109]In 1960s and 1970s the government of India took some measure for the development of agricultural sector. In this regard, the financial institutions were asked to increase the supply and reduce the rate of interest for agricultural sector. In this connection, special cheap lines of credit were provided to the lenders. Incentives were given to those financial institutions that opened branches in rural areas of the country. In addition, specialized banks (agricultural banks) were created by the state in order to play its role in the development of agricultural sector both for crop and non crop activities. …………Richard L. Meyer, *Microcredit and Agriculture: Challenges, Successes, and Prospects*,p.2 https://www.incofin.com/sites/.../Microfinance%20and%20agriculture.pd.(accessedOctober 17, 2013).

[110] Mahmoud A.Gulaid, Financing *Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia: Islamic Research And Training Institute Islamic Development, Bank, 1995) Research no.34, p.50.

[111]These reasons include inflation, credit quality provided by the financial institutions, federal reserves, supply (the volume of issuance in the over all bond markets has a clear long term influence on interest rates-more supply leads to higher rates),demand(investor's demand for bond is another determinant of interest rate) etc **……..***What Causes Interest Rates to Rise*, http:// www.janney.com/.../Janney-Interest-Rates-What-Causes_FINAL.pdf(accessed October 16, 2013).

[112]Catherine Guirkinger, *Understanding the Coexistence of Formal and Informa Credit Markets in Piura*, Peru, Center for Research in Economic Development University of Namur, Belgium September 2006,p.2, https://pure.fundp.ac.be/ws/files/1016771/58150.pdf(accessed October 16, 2013).

Many of the scholars have worked on the issue of how to decrease the interest rates in agricultural finance, particularly when the loan is provided to the lower class of farmers for whom agriculture is a source of life. These scholars have particularly discussed the following issues:

- Reduction in the transactional cost of agricultural loans,
- Intervention of the government in agricultural finance,
- Commencement of subsidized loans for farmers particularly of lower class,
- Simplification of the loan procedure, and
- Opening of specialized agricultural banks owned by the state.

The issue of transactional cost is discussed by the scholars and they also present viable solutions. In this regard, the work of S. S. Hosseini, M. Khaledi, M. Ghorbani, and D. G. Brewin is noteworthy.[113] They first classify the transactional cost into seven various types including traveling costs (the costs incurred by the borrowers in contacting or visiting the banks), opportunity costs (the total time spent in the processing of the credit), paperwork cost (the cost of completing the forms including photocopies of documents, taking pictures, obtaining personal documents, application fees and others), office (legal) costs (legal fees paid to law firms, attorneys, and public offices), guarantee and collateral costs (the costs incurred for securing the loan before the credit is issued), expert and controlling costs (the costs imposed on borrowers for the control and monitoring of their credit by experts and other costs (any other costs incurred in the process of obtaining credit). The sum of all these costs is called transactional cost. The work of Hosseini and his colleagues is very comprehensive as they even discuss various methods of transactional cost estimation used by the financial institutions.[114] Their results are very reliable as their analysis is based on data collected from 459 respondents. However, because the study is purely related to the transactional cost in the rural areas of Iran, their results cannot be

---

[113]S. S. Hosseini, M. Khaledi, M. Ghorbani, and D. G. Brewin, *An Analysis of Transaction Costs of Obtaining Credits in Rural Iran,* J. Agr. Sci. Tech. (2012) vol. 14: 243-256.

[114]In their view, the contracting parties can determine the transactional cost in relative terms which means percentage of the total loan provided to the debtor or a percentage of the interest rat. It can also be measured relatively on the basis percentage rate comparable to an annual interest rate………… S. S. Hosseini, M. Khaledi, M. Ghorbani, and D. G. Brewin, *An Analysis of Transaction Costs of Obtaining Credits in Rural Iran,* J. Agr. Sci. Tech. (2012) vol. 14: 243-256.

generalized to other areas. Similarly, many of the transaction costs which are mentioned in the study are not regarded as important in other parts of the world (i.e. waiting time, number of visits to the financial institutions). These costs are usually very minute and are, therefore, not considered by the financial institutions in agricultural credit. Besides, the authors discuss those types of transactional cost which are mostly available in rural credit. Urban credit has its own salient features in terms of transactional cost. This also further limits the scope of this work.

Another important work on transactional cost in agriculture finance was conducted by Irma C. Corales and Carlos E. Cuevas.[115] Their division of transactional costs includes cost of funds, administrative expenses, risk expenses, and the imputed costs of carrying loan arrears (but this was separated from the actual financial cost).[116] The work of these scholars is very inclusive as they discuss the issue from all directions. For instance their work deals with various types of cost incurred by the financial institutions on agricultural loans, comparison of agricultural and non-agricultural loan costs, method of estimation of costs, effects of lending costs on interest rates' deregulation, cross country comparisons of cost estimates, etc. Findings of the work are very reliable as the authors critically analyzed the transactional cost from all possible directions although there are some drawbacks. For example, the work is purely related to the issue of agricultural credit's costs to the farmers in the Philippines and, therefore, the study lacks the characteristic of generalizability. Similarly, the study does not purely deal with the issue of transactional costs rather it concentrates more on the effects of such costs in agricultural credit on the deregulation of interest rates. In addition, the data used in the work for the derivation of the findings is not empirically tested, placing doubts on their utilization for any practical utility.

---

[115]Irma C. Corales and Carlos E. Cuevas, *Cost of Agricultural Credit in the Philippines: the Short-Run Effects of Interest Rate Deregulation*, Working Paper Series No. 87-02,http:// dirp4.pids.gov.ph/ris/wp/pidswp8702.pdf (accessed October 17, 2013).

[116]By the cost funds, the author has two meanings i.e.the pure cost of funds and the transactional cost of mobilizing these funds which includes wages and other direct expenses associated with deposit taking and borrowing activities. The administrative costs consist of variable and fixed overhead expenses related to the delivery process and administration of loan. The risk expenses are also included in the transactional cost and consist of two headings i.e the first one is the loan guarantee fee and insurance premium payments pertaining to specific loan type s, mainly for agriculture loans; while the second one is the bad debt expenses. The fourth type of cost is imputed cost of carrying loan arrears …………………..Irma C. Corales and Carlos E. Cuevas, *Cost of Agricultural Credit in the Philippines: the Short-Run Effects of Interest Rate Deregulation*, Working Paper Series No. 87-02, pp.10-12http:// dirp4.pids.gov.ph/ris/wp/pidswp8702.pdf (accessed October 17, 2013).

The most important question related to the issue of transactional cost is how it can be reduced to a realistic level, for when the agricultural credit is provided to the lower class of farmers. Harsha de Silva and Dimuthu Ratnadi wakara have appropriately dealt with this question in their work.[117] They discuss the role of specific information and communication technologies for the reduction of transactional cost in agriculture credit. Such technologies provide timely and affordable communication, which paves a way for a dramatic reduction in the cost. The work is mainly focused on the reduction of cost in agriculture through better communication system; however, it can be effectively applied with some necessary amendments in other parts of the world.

The agricultural sector of any country cannot be developed without vigorous involvement of a concerned government. This involvement is usually of various nature involving the enacting of assorted laws related to the agricultural sector[118], effective agricultural policies and planning, establishment of specialized agricultural educational institutions[119], specialized agricultural financial institutions like agricultural banks[120], provision of agricultural subsidies[121] on various

---

[117]Harsha de Silva and Dimuthu Ratnadiwakara, *UsingICT to Reduce Transaction Costsin Agriculture through Better Communication: a Case-Study from Sri Lanka*, http:// www.lirneasia.net/wp-content/uploads/2008/11/transactioncosts.pd (accessed October 22, 2013).

[118]see for example in case of Pakistan Article No 261(a) of the Constitution of Pakistan (1973 Constitution) ,which defines Agricultural Income and its various aspects, Pakistan Land Revenue Act of 1967 , Law of Agricultural Sector of Punjab, Pakistan Plant Quarantine Act of 1976,Plant Quarantine Rules,1967,Seed Act 1967;The Agricultural produce(Grading and Marking) Act 1037,The cotton Standardization(Amendment Act 2008 etc.

[119]For example in case of Pakistan there are many specialized agricultural educational institutions i.e Agricultural university Faisalabad; university of Arid Agriculture Rawalpindi; NWFP Agriculture University Peshawar; Lasbella University of Agriculture, Water and Marine Sciences, Uthal, Lasbella; Sindh Agriculture University;Tandojam, University College of Agriculture ,B.Z.U, Multan ;University College of Agriculture D.G.Khan (UAF); Agriculture College Balleli Road, B.U, Quetta; University College of Agriculture Rawalakot, AJK University, AJK; Z.A Bhutto Agriculture College Dhokri, Larkana (S.A.U. Tando Jam); University College of Agriculture ,Depalpur (UAF) etc …….Agriculture Education Institutions In Pakistan http:// www.sindhagri.gov.pk/notification/list%20of%20agri%20inst.pdf(accessed November 17, 2013).

[120]For example in case of Pakistan Zarai Taraqiati Bank Limited is the specialized financial institution for the development of agriculture sectorboth in crop and non crop activities. It was formerly known as Agricultural Development Bank of Pakistan. The main purpose behind the establishment of such financial institution to provide financial products and technical services to the farming community through efficient and professional manner………http:// www.ztbl.com.pk (accessed November 17, 2013).

[121]An agricultural subsidy is a financial support which is usually provided by the concerned government to the farmers for the development of agricultural sector. It is mostly used for the purchase of various agricultural inputs

agricultural commodities (when these commodities are purchased by a farmer from the local market) and agricultural loans (when such loans are provided by the financial institutions), insurance of agricultural products, etc. However, provision of subsidies is considered as a very important role of the government in the development of the agricultural sector in all its sub sectors and, particularly, local farming.

The subsidies provided by the government for the development of the agriculture sector have been discussed by experts of agricultural finance from various angles in order to analyze the advantages and disadvantages of such subsidies, procedures for their provision, their effects on the development of agricultural sector, the nature of such subsidies, amount involved therein, their fixation for various purposes, and the time frame for which they are allocated. Jason Clay's work critically discusses the issue of agricultural subsidies.[122] He adds that in the last 13 years (from 2001 to 2013), the developing countries like India and Brazil have rapidly increased the provision of subsidies to the agricultural sector. This may increase development in many aspects in regard to innovation in agriculture, creation of a strong middle class, production of surpluses for export purposes, and, even, elimination of poverty particularly in rural areas. In his view, it is only one side of the picture as, on the other hand, agricultural subsidies also create harms that sometimes outweigh their goods. For example, in India, the farmers have started using more water when they realize that the cost of energy is subsidized by the government. Clay further adds that global subsidies may also encourage the farmers to use more fertilizers and pesticides that could lead to negative environmental outcomes. However, the author's view may not be applicable for the agricultural sector of each and every country. Moreover, the problems mentioned above can be solved through some other measures. For example, subsidies on the cost of energy should be provided for a particular level of consumption. In this way extreme

---

(particularly in the beginning of a season like best quality seeds, fertilizers, herbicides, weedicides, insecticides etc) .It is also used for the reduction of high interest rate charged by a financial institution on agricultural loans. It is not necessary that such subsidies will be always provided by the government and there are some other sources which can provide the same like NGOs. Such subsidies can be divided into two kinds I.e. direct and indirect .The direct subsidies include cash grants, interest free loan and etc while the indirect include concession in tax, insurance rent rebates etc. The most important purpose of such subsidies is however, to reduce the market price of an item below the cost of its production…………….see for more details http:// www.wisegeek.org/what-are-agricultural-subsidies.htm (accessed November 5, 2013).

[122]Jason Clay, *Are Agricultural Subsidies Causing More Harm than Good?* , Guardian Professional, August 2013 ,http:// www.theguardian.com › Professional › Guardian Sustainable Business(accessed November 17, 2013).

consumption of energy will be discouraged. The overuse of fertilizers and pesticides can be dealt with in the same way. In addition, the farmers should be given information about the proper application of fertilizers. Todd Benson, Stephen L. Kirama, and Onesmo Selejio have the same view.[123] They explain that these would be a better strategy rather than looking to eliminate subsidies from the agricultural sector as that would harm the majority of the farmers who belong to the poor sectors of the society.[124]

Another important work on the issue of subsidies was conducted by M.Ghaffar Chaudhry and Shamim A. Sahibzada.[125] Their work mainly focuses on the history of agricultural input subsidies in Pakistan and their impact on the development of the agricultural sector both for crop and non-crop activities.

The research of Timothy A. Wise is also considered important work on the issue of agricultural subsidies.[126] Wise examines the economic and policy aspects of subsidy debate asking the question, “When are subsidies not subsidies?” This portion of his research considers various flaws in the measurement of subsidies. However, the work is limited in terms of its applicability as it is restricted to the study of issues involved in the subsidies’ program of a few regions.

---

[123]Todd Benson, Stephen L. Kirama ,Onesmo Selejio ,*The Supply of Inorganic Fertilizers to Smallholder Farmers in Tanzania Evidence for Fertilizer Policy Development* , IFPRI Discussion Paper 01230 December 2012, International Food Policy Research Institute Development Strategy and Governance Division http:// www.ifpri.org/sites/default/files/publications/ifpridp01230.pdf (accessed November 18, 2013).

[124]In many countries majority of farmers belong to lower class of the society…..see for example the work of Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, Vol. 38, No. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716;Dale W. Adams, A*gricultural Credit in Latin America*: *A Critical Review of External Funding Policy*,American Journal of Agricultural Economics,vol. 53, no. 2 (May, 1971), pp. 163-172;*Strengthening Agricultural support Services For Small Farmers*, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

[125]M.Ghaffar Chaudhry, Shamim A. Sahibzada, *Agricultural Input Subsidies in Pakistan: Nature and Impact*, The Pakistan Development Review 34 : 4 Part II (Winter 1995) pp. 711—722, http://www.pide.org.pk/pdr/index.php/pdr/article/view/1399/1372ýý(accessed November 22, 2013).

[126]Timothy A. Wise, The *Paradox of Agricultural Subsidies: Measurement Issues, Agricultural Dumping, and Policy Reform*, May 2004, Tufts University Medford MA 02155, USA, http://www.ase.tufts.edu/gdae/Pubs/wp/04-02AgSubsidies.pdf(accessed November 22, 2013).

In addition to the works referred to above, several other established works have been conducted on various aspects of agricultural subsidies. The research of Burtn Fosom, Jr.[127], Aziz Elbehri[128], John Lingard[129], Caroline Franck, Sonia M. Grandi, and Mark J. Eisenberg[130], Carlos Mulas-Granados, Taline Koranchelian, and Alex Segura-Ubiergo[131], Fred Gale, Bryan Lohmar, and Francis Tuan[132], Kari Hamerschlag[133], Zoé Druilhe and Jesús Barreiro-Hurlé[134], Aziz Elbehri and Susan Leetmaa[135], Hiroyuki Takeshima and Hak Lim Lee[136], Antonio La Vina, Lindsey Fransen Paul Faeth and Yuko Kurauchi[137] Andrew Dorward, Peter Hazell and Colin Poulton[138], Ruxanda Berlinschi, Jo Swinnenand Kristine Van Herck[139], Amy M. Nagler, Dale J. Menkhaus, Christopher T. Bastian, and Mariah D. Ehmke[140], and S.Mahendra Dev[141]

[127]See for example his Burtn Fosom JR, *The Origin of American Farm Subsidies*, http://brent.fm/wp-content/.../farmer-government-subsidies-0604-folsom.pdf (accessed November 22, 2013).

[128]See for example his work Aziz Elbehri, *Agricultural Export Subsidies*, http:// www.gtap.agecon.purdue.edu/resources/download/643.pdf (accessed November 22, 2013).

[129]John Lingard, *Agricultural Subsidies and Environmental Change*, ,http:// www.wiley.com/legacy/wileychi/egec/pdf/GB403-W.PDF(accessed December 30, 2013).

[130]Caroline Franck, Sonia M. Grandi, Mark J. Eisenberg, *Agricultural Subsidies and the American Obesity Epidemic*, (Under Embargo Until July 9, 2013, 12:01 Am Et), http:// www.ajpmonline.org/webfiles/images/.../3834-stamped-070913.pdf(accessed December 30, 2013).

[131]Carlos Mulas-Granados, Taline Koranchelian, and Alex Segura-Ubiergo, *Reforming Government Subsidies in theNew Member States of the European Union*, IMF Working Paper July 2008, https://www.ucm.es/data/.../5-Reforming%20government%20FMI.pd(accessed December 30, 2013).

[132]Fred Gale, Bryan Lohmar, Francis Tuan, *China's New Farm Subsidies*, F Electronic Outlook Report from the Economic Research Service, http://www.ers.usda.gov/ersDownloadHandler.ashx?file=/media/872040/ accessed December 30, 2013).

[133]Kari Hamerschlag,*Farm Subsidies in California*:*Skewed Priorities and Gross Inequities*, http://farm.ewg.org/pdf/california-farm.pd(accessed December 30, 2013).

[134]Zoé Druilhe and Jesús Barreiro-Hurlé, *Fertilizer subsidies in sub-Saharan Africa*, ESA Working paper No. 12-04 July 2012, http://www.fao.org/docrep/016/ap077e/ap077e.pdf, (accessed December 30, 2013).

[135]Aziz Elbehri Susan Leetmaa,*How Significant are Export Subsidies to Agricultural Trade? Trade and Welfare Implications of Global Reforms*, Paper presented as a Selected Paper at the 5th Annual Conference on Global Economic Analysis, June 5-7, 2002, Taipei, Taiwanhttp://ageconsearch.umn.edu/bitstream/20518/1/sp01el02.pdf(accessed December 30, 2013).

[136]Hiroyuki Takeshima and Hak Lim Lee, *Monitoring and Evaluation of Agricultural Subsidy Program*, http://www.ifpri.org/sites/default/files/publications/mssppn2.pdf (accessed December 30, 2013).

[137]Antonio La Vina, Lindsey Fransen Paul Faeth ,Yuko Kurauchi, Re*forming Agricultural Subsidies: "No Regrets" Policies for Livelihoods and The Environment*,World Resource Institute,pdf.wri.org/reforming_ag_subsidies.pdf(accessed December 30, 2013).

[138]Andrew Dorward, Peter Hazell ,Colin Poulton, *Rethinking Agricultural Input Subsidies in Poor Rural Economies*, September 2007,Future Agriculture, http://www.future-agricultures.org/.../22-rethinking-agricultural-input-subsidie(accessed December 30, 2013).

2.1.3. Literature Review of Islamic Agricultural Finance

Being a perfect code of life, Islam covers, in term of guidance, each and every aspect of life either with the provision of broad based principles or through the introduction of very specific details.[142] Some verses of the Holy *Qur'ān* convey this same message.[143] Because agriculture is one of the most important aspects of human life on the earth, it is also discussed in various facets such as animate of dead earth[144], description of various agricultural products as a

---

[139]Ruxanda Berlinschi, Jo Swinnen ,Kristine Van Herck, *Subsidies and Agricultural Employment:The Education Channel*,(Selected Paper prepared for presentation at the International Association of Agricultural Economists (IAAE) Triennial Conference, Foz do Iguaçu, Brazil, 18-24 August, 2012), http://ageconsearch.umn.edu/bitstream/126776/2/Berlinschi.pdf(accessed November 1st, 2013).

[140]Amy M. Nagler, Dale J. Menkhaus, Christopher T. Bastian, Mariah D. Ehmke, Subsidy Incidence in Agricultural Land Markets: An Experimental Investigation, (Selected Paper prepared for presentation at the Agricultural & Applied EconomicsAssociation's 2011 AAEA & NAREA Joint Annual Meeting, Pittsburgh, Pennsylvania, July 24-26, 2011), http://ageconsearch.umn.edu/.../Subsidy%20Incidence_AAEA%20Selected%2.(accessed November 1st, 2013).

[141]S.Mahendra Dev, Subsidies and Investments in Indian Agriculture, Issues and Perspectives, RGICS Paper No.39 (New Delhi: Rajiv Gandhi Institute forContemporary Studies, 1997) [PDF Version: 2010]. http://www.rgics.org/pdf1/wpo-39.pdf(accessed November 1st, 2013).

[142]For example in case of commercial matters , some broad principles are provided I.e. prohibition of interest based transaction, deception, taking others wealth through wrong doors, game of chance, hoarding etc. The parties are free to structure, organize and enforce any commercial contract according to their own wishes if they do not violate any of the above mentioned basic principles and some others. On the other hand in case of family law , Islam provides various issues with minute details e.g. the law of inheritance , the law related to the contract of marriage and its ancillary issues like consent of the parties ,their age of puberty etc, the law related to the issue of divorce and other connected and linked issues etc.

[143]"There is not an animal (That lives) on the earth, Nor a being that flies on its wings, but (forms Part of) communities like you. Nothing have we omitted From the Book, and they (all) Shall be gathered to their Lord In the en". *(Qur'ān 6:38)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 15 July2012);One day We shall raise From all Peoples a witness Against them, from amongst themselves:And We shall bring thee As a witness against these (Thy people): and We have sent down To thee the Book explaining All things, a Guide, a Mercy, And Glad Tidings to Muslims". *(Qur'ān 16:89)*translated by Abdullah Yūsuf Alī), (1872–1953);http://www.quran4u.com/quran_english_Yeh.htm(accessed: 15 July2012).

[144]Behold! In the creation Of the heavens and the earth; In the alternation Of the Night and the Day; In the sailing of the ships Through the Ocean For the profit of mankind; In the rain which God Sends down from the skies, And the life which He gives therewith To an earth that is dead; In the beasts of all kinds That He scatters Through the earth; In the change of the winds, And the clouds which they Trail like their slaves Between the sky and the earth;— (Here) indeed are Signs For a people that are wise. (*Qur'ān 2:64)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013); And God sends down rain From the skies, and gives therewith Life to the earth after its death: Verily in this is a Sign For those who listen*. (Qur'ān 16:65)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);A Sign for them Is the earth that is dead: We do give it life, And produce grain there from, Of which ye do eat. And We produce therein Orchards with

blessing, benefits of livestock, etc. Therefore, some of the renowned Muslim jurists have also built-in the agriculture sector and various issues involved therein in their own work. The majority of these jurists have devoted separate chapters of their work to the concept of *Muzāraʾah*, *Musāqah*, and *Salam*. All these concepts are purely related to local farming of the agriculture sector. These jurists include Imām al-Shawkānī[147], Imām al-Kāsānī[148], Ibn Qudāmah al-Maqdisī[149], Abū al-Walīd Muhammad ibn Ahmad ibn Rushd[150], Imām Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī[151], and Ibn ʿĀbidīn[152]. Among these jurists, the work of Imām

---

date-palms And vines, and We cause Springs to gush forth therein: *(Qur'ān 36:33,34)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013).

[145]Who has made the earth your couch, And the heavens your canopy; And sent down rain from the heavens; And brought forth therewith Fruits for your sustenance; Then set not up rivals unto God When ye know (the truth). *(Qur'ān 2:22)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);It is He Who sends down Rain from the sky: From it ye drink, And out of it (grows) The vegetation on which Ye feed your cattle With it He produces For you corn, olives, Date-palms, grapes, And every kind of fruit: Verily in this is a Sign For those who give thought*(Qur'ān 16:10,11)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);And who bringeth out The (green and luscious) pasture, And then doth make it (But) swarthy stubble. *(Qur'ān 137:4, 5)*translated by Abdullah Yūsuf Alī), (1872–1953);http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013).

[146]And cattle He has created For you (men): from them Ye derive warmth, And numerous benefits, And of their (meat) ye eat. And ye have a sense Of pride and beauty in them As ye drive them home In the evening, and as ye Lead them forth to pasture In the morning. And they carry your heavy loads To lands that ye could not (Otherwise) reach except with Souls distressed: for your Lord Is indeed Most Kind, Most MercifulAnd (He has created) horses, Mules, and donkeys, for you To ride and use for show; And He has created (other) things Of which ye have no knowledge. *(Qur'ān 16:5-8)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);See they not that it is We Who have created For them—among the things Which our hands have fashioned— Cattle, which are under Their dominion? —And that We have Subjected them to their (use)? Of them some do carry them And some they eat: And they have (other) profits From them (besides), and they Get (milk) to drink. Will they not then Be grateful? *(Qur'ān 36:71-72)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);Eat (for yourselves) and pasture Your cattle: verily, in this Are Signs for men Endued with understanding.*(Qur'ān 20:54)*translated by Abdullah Yūsuf Alī), (1872–1953);http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013).

[147]Shawkānī, *Nayl al-Awtār*, (Dār Ehiā al-Tourath al-ʿArabī, 1st Edition.2001).

[148]Abū Bakr ibn Masʿūd al-Kāsānī, *Bādā'i'al-Sanā'i'*,1st Edition, (Beirut: Dār al-Fikr Labnan, 1996), Kitāb-al Sharikah.

[149]Ibn Qudāmah al-Maqdisī, *Al-Kafī*, 5th Edition, (Beirut: Al-Maktab al-Islāmī, 1988).

[150] Abū al-Walīd Muhammad ibn Ahmad ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, Vol. 2, 1st Edition. (Beirut: Dār al-Fikr Labnan, 2003).

[151]Abū Bakar Muhammad ibn Abī Sahal Sarakhsī, *Al-Mabsūt*, (Beriut: Dar-Ehyā al-Turāth al-Arabi, Edition.2002).

[152]Ibn ʿĀbidīn, *Radd al-Muhtār*, vol. 6, (Beirut: Dār al-Fikr, 2005).

Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī[153] is very remarkable and discusses these three agricultural specific transactions with much detail. Among these transactions, the contract of *Salam* is specially designed to help out the farmers financially in the beginning of a season in order to buy basic agricultural inputs. The following statement of Mufti Muhammad Taqi Usmani, can be cited as support.

> *Salam* was allowed by the Holy Prophet (SAW) subject to certain conditions. The basic purpose of this sale was to meet the needs of the small farmers who needed money to grow their crops and to feed their family up to the time of harvest. After the prohibition of *Ribā* they could not take usurious loans. Therefore, it was allowed for them to sell the agricultural products in advance...[154]

However, the question may be asked as to why these classical Muslim jurists discuss the concepts of *Muzāraʽah*, *Musāqah,* and *Salam* and their rules and regulations with microscopic details yet pay no attention to the application of other modes of Islamic finance like *Mushārakah* (partnership), *Murābahah* (sale with profit)*, Ijārah* (leasing), *Salam* (advance payment sale), and *Istisnāʻ*(manufacturing contract). This question can be easily understood if the environmental conditions of Arabian are accurately studied. The people of that area were vigorously involved in commercial business activities and they used to visit various parts of the world for trade. Their inclination towards trade was due to the lack of a suitable environment for agricultural activities. Even today the majority of the Arab countries have less arable land and their economy mostly relies on industries like crude oil production, petroleum refining, basic petrochemicals, ammonia, industrial gases, sodium hydroxide (caustic soda), cement, fertilizer, plastics, metals, commercial

---

[153]Imām Abū Bakar Muhammad ibn Abī Sahal Sarakhsī was a prominent jurist of the Hanafi School in the 11th century .He was also known as "Shams ul al-A'imma ("the sun of the leaders").He was in prison for more than 15 years due to his juristic opinion against the ruler of the time. The mentioned book is a collection of his lectures delivered by him to his disciples while he was in prison. It is a very comprehensive book, spread over 30 volumes, contains detailed discussion of *ibādah* and *muʽamalah*. He discusses all their related issues in very details and tries to elaborate each and every single issue with practical examples from daily life. His work can be affectively used for introducing new methodology in the field of research related Islamic jurisprudence. He also has a book on the principle of Islamic jurisprudence which is an evidence of his intellectual capacity both in Islamic Law and its jurisprudence. He is considered an authority by the classical and contemporary jurists and weightage is always given to his jurisprudential verdicts.

[154]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, (Karachi: Maktaba Maʽariful Quran, Edition August 2008) p.186.

ship repair, commercial aircraft repair, and construction. For instance, Saudi Arabia, a major Arab country, has only 2% arable land.[155] Other Arab countries like Iraq, Jordan, Egypt, Syria, and Kuwait have 13.2%, 3.32%, 3%, 25%, and 0.84% respectively.[156]

The classical Muslim jurists have discussed all modes of the Islamic financial system with special reference to trade and not agriculture. However, it does not mean that the work of such jurists has no value as far as contemporary agricultural finance is concerned. They discuss rules and regulations for all these commercial transactions in such a broad way that it can be easily extended for financing agriculture both for crop and non crop activities. Because of their work, it becomes possible for modern-day scholars to use and apply all these commercial transactions to any area that entails financial backing from Islamic banks and other Islamic financial institutions.

Some of these contemporary scholars work on the application of various modes of Islamic finance with a special reference to the agricultural sector. These scholars include Muhammad A. Gulaid[157], Maulana Muhammad Taqī ʿUthmānī, Brian B. Kettell[158], Monzer Kahf and M. Fahīm Khan[159], Magda Ismail Abdel Mohsin[160], Laurence M. Crane and David J. Leatham[161], Adam B. Elheraika[162], Ali Yasserī[163], Saeed Yazdanī[164] etc.

---

[155]The information are taken from the official website of Fact Monster, http://www.factmonster.com › World › Countries(accessed: 25 December 2013).

[156]The fact are taken from the official website of infoplease http://www.infoplease.com/country/iraq.html(accessed: 25 December2013).

[157]Muhammad A. Gulaid, *Financing Agriculture Through Islamic Modes and Instrument*: Practical Scenario and Applicability, (Jeddah: Islamic Research And Training Institute, Islamic Development Bank, 1995) Research Paper No. 34, p. 50.

[158]Brian B. Kettell, *Introduction to Islamic Banking and Finance*, (John Wiley & Sons, 2011).

[159]Monzer Kahf & M. Fahīm Khan, *Short-Term Financing of Commodity Production in Islamic Perspective*, Paper to be presented to the 7th Annual Meeting of Experts in Islamic Banking, Spring 1992 (Kuala Lumpur, 1992).

[160]Magda Ismail Abdel Mohsin, "*The Practice of Islamic Banking System in Sudan*", Journal of Economic Cooperation, 26/4 (2005): 27-50.

[161]Laurence M. Crane & David J. Leatham, *Profit and Loss Sharing in Aagriculture: An Aapplication of Islamic Banking*, Vol. 9/4, (Agribusiness, 1993), pp. 403-412.

[162]Adam B. Elheraika, *Onthe Experience of Islamic Agricultural Finance in Sudan: Challenges and Sustainability* (Jeddah: Islamic Research and Training Institute Islamic Development Bank, 2003), 74 pp. Reviewed by Ahmed S. Bamakhramah, Faculty of Economics and Administration Department of Economics King Abdulaziz University Jeddah, Saudi Arabia; See also Adam B. Elhiraika, "*Risk-Sharing and the Supply of Agricultural Credit: A Case Study of Islamic Finance in Sudan*, Journal of Agricultural Economics, "47/1-4 (1996): 390-402

The worldwide food shortage is intensely felt by the scholars of the field. Eric Holt-Gimnez asserts that such a food shortage has affected over three billion people (half of the world's population).[165] Some steps have been taken by Islamic states in order to overcome these problems and achieve their alternate objectives to surmount the food shortage. The first step is to encourage the Muslim scholars, who have expertise in Islamic finance, to develop a theoretical framework for financing agriculture through Islamic commercial transactions.

A very comprehensive work on Islamic agricultural finance was conducted by a well renowned economist, Hassan Yusuf Davood.[166] His work would be considered a pioneer one, the first that discussed the use of various Islamic commercial transactions for the development of the agricultural sector both for crop and non-crop activities in detail. The first portion of his work dealt with the general frame work of Islamic commercial law, followed by a profound discussion on how it could be used effectively for financing agriculture.[167] In addition, he critically analyzed the negative effects of interest based financing with minute details. In his view, the commercial loan had only increased the financial burden of farmers and created numerous problems for them. He cited the example of Bangladesh where the majority of lower class of farmers had lost their small pieces of land because they were not in a position to return their loan over the prescribed time. Davood's work, however, had a number of shortcomings. Firstly, the methodology of his research was theoretical and modern tools for research were not used. For example, a major portion of his research was derived from the theory of classical Muslim jurists and no empirical evidence [168] had been provided. In this way the work lost its importance at the

---

[163]Ali Yasseri, *TheExperience of the Islamic Republic of Iran in Mushārakah Financin*g, Arab Law Quarterly, 14/3 (1999): 231-224.

[164]Saeed Yazdani, "*An Evaluation of Agricultural Credit System in Iran*", Giordano Dell-Amore Foundation, Savings and Development, 29/2 (2005); 117-132.

[165]Eric Holt-Gim nez, *The World Food Crisis: What is BehindiIt and What We Can Do*,http://www.worldhunger.org/articles/09/editorials/holt-gimenez.htm (accessed July 30, 2013).

[166] Hassan Yusuf Dawood, *Al Masraf ul Islamī lil Istismāre al Zira'ī* " Namozaj Muqtareh" ,(Dra al Nushr lil Jamā'at Misr Al Qahera), 1st Edition 2005.

[167]For example the author thoroughly discussed that how the Islamic banks and other Islamic financial institutions can use various modes of Islamic financial system i.e.*Mudārabah,musāqah,muzāra'ah* (temporary sharecropping contract), *Istisnā'*etcfor financing agricultural sector.

[168]Empirical evidence is that kind of evidence which is derived from direct observations, experience or situation. This evidence is solid and can be believed as it is shown directly to the researcher. There is no doubt in such sort of

practical stage or level based on the philosophy that a theory could not be proved unless experienced at the ground level. Second, the work did not discuss agricultural finance as it related to rural areas that were the hub for the majority of farmers.

How Islamic finance can be used for the development of the agricultural sector is also discussed by Mahmoud A.Gulaid.[169] After clearly laying out his objectives for the study and explaining the methodology adopted for his work, he discusses the production marketing process in agriculture making sure the relationship between agriculture and other economic sectors. Finally, he identifies how Islamic banks and other Islamic financial institutions can finance various agricultural activities through existing financing techniques. The work is valuable in the contemporary scenario as the author has an extensive work experience with Islamic banking and its various financing tools. Similarly, the research is very useful and practicable for the Islamic banks and other Islamic financial institutions in the sense that it is prepared under the guidance of a premier Islamic bank (i.e. Islamic Development Bank Jeddah Saudi Arabia).[170] However, the work has some drawbacks. For example, the research mainly focuses on local farming particularly that of rural areas, while completely ignoring other important sectors of agriculture such as livestock, poultry farming, fish farming, horticulture, and dairy farming. The work also shows a deficiency in its theoretical framework as it is not based on strong solid arguments particularly from the work of classical Muslim jurists.

---

evidence as it is always based on physical evidence………….. (See for further details http://www.reference.com/motif/science/what-is-empirical-evidence (accessed: 19thJanuary,2014).

[169] Muhamoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50.

[170]The Islamic Development Ban was established on 20th October, 1975 for the purpose to foster the economic development and social progress of its member countries and Muslim communities individually as well as collectively according to the principles laid down by the Holy Quran and Sunnah of the Holy Prophet (SAW) i.e. Islamic Law. The various function of the bank is to participate in equity capital and grant loans for productive projects and enterprises. In addition to this, the bank also provides financial assistance to its member countries for the economic and social development. The bank is also required to establish and operate special funds for specific purposes including helping out of those Muslim communities which are living in non member countries. Its whole business is based on the principles of Islamic commercial law ……………………… (See for details http:// www.isdb.org/ accessed: 28th January,2014).

Islamic agricultural finance is conducted by Abdul Aziz Muhammad Rizwan.[171] The work describes agriculture with a special reference to economic, banking and finance. In fact, all three of the disciplines are directly related to the subject of agricultural finance. Rizwan's work provides an amalgamation of classical and contemporary research on Islamic agricultural finance and agribusiness.[172] On one hand he embarks on various classical agricultural contracts like *Muzāra'ah, Musāqah* and *Salam* along with their detailed rules and regulations provided in the classical books of Muslim jurists. Then, on the other hand, he discusses various financing facilities which can be provided for agro entrepreneurs by the modern Islamic banks and other Islamic financial institutions. Despite its importance, the work can also be critically evaluated from various slants. For instances; it discusses those models which are already developed by the contemporary Muslim jurists in light of the established work of classical Muslim jurists. Because of this, Rizwan's work cannot be called innovative. In the same way, this research is also limited in terms of applicability as it was conducted purely in Malaysia.

Al-Hashimi and Muhammad Ali Alula also provide a scholastic contribution for the development of the agriculture sector through Islamic finance.[173] They discuss the influence of Islamic banking in the development of Sudan's agriculture through a famous transaction of Islamic commercial law, *Mudārabah*. They portray the whole mode of Islamic finance and how it is applied by the banks to finance the poor rural agriculturalist in Sudan who seek capital for various agricultural activities. They explain that such a transaction is more beneficial than a conventional loan as the latter is less accessible and exploitative to farmers. The research of these scholars has provided a valuable guideline for all Islamic banks and, particularly, those in Sudan.

---

[171] Ab. Aziz, Muhammad Ridhwan, *Agriculture in Islam from the Perspective of Economics, Banking & Finance.* Penerbit UTM, Skudai, Johor Bahru, 2012.

[172] For example his work includes a series of topics which are directly related to agricultural sector like agribusiness from the Islamic perspective, agriculture as a tool to resolve the issue of unemployment, various contract of agriculture in Islamic commercial law, various *Shari'ah* based models which can be easily applied by the contemporary banks for the development of agricultural sector both for crop and non crop activities etc. The book discusses all these issues with a special reference to Malaysian's agriculture…………see for further details Ab. Aziz, Muhammad Ridhwan, *Agriculture in Islam from the Perspective of Economics, Banking & Finance.* Penerbit UTM, Skudai, Johor Bahru, 2012.

[173] Al-Hashimi, Muhammad Ali Alula, *The Influence of Islamic Banking on Agricultural Development in Sudan*, Graduate Research Masters Degree Plan B Papers 10994, 1989, Michigan State University, Department of Agricultural, Food, and Resource Economics.

Their study, however, has limited application being that it mainly focuses on the development of Islamic agricultural finance in Sudan.[174]

Muhammad Ridhwan Ab. Aziz and Muhammad Mohamad Yusoff have also contributed to the development of Islamic agricultural finance through their scholastic work.[175] The contribution of these scholars is unique in two ways. First, they present a comprehensive financing mechanism for funding agro based projects. This mechanism is purely based on the principle of *Sharīʿah* and in particular those principles which are related to Islamic commercial law meaning that the study is based on a strong theoretical background. Second, the research is conducted while using qualitative methods where the previous writings on the same issue are thoroughly studied. The authors have reached the conclusion that Muslim farmers must use *Sharīʿah* compliant instruments for their agro projects. They further add that this will benefit them in two ways i.e. they will earn *Halāl* money and their efforts will be accepted as *Ibādah* by the Lord of the universe. They view the system of Islamic banking and finance as having the trust of both Muslims and non-Muslims due to its moral and ethical principles envisaged by Islam for the success of such a system. However, the work of both these scholars can be critically evaluated from various angles. For example the work is theoretical as it mainly relies on previous studies that have adopted a descriptive style of research. The findings are not accurately tested through empirical methods. A theory presented by a scholar anticipating that it will fulfill the intended objectives has often failed when placed in reality. It is, therefore, always wise for scholars to test their theory through a questionnaire or another tool of scientific research in order to confirm its usefulness before sending it for a practical utility. This does not mean, however, that every theory fails when tested and there are countless successful theories that were based on strong logical grounds. This work is also defective as it mainly focuses on Malaysian agriculture and various projects which are used therein. Due to this fact, the findings of the study

---

[174]The authors have discussed the contract of *Mudārabah* with a special reference to Sudan's agriculture. However, based on the logic that each and every country has its own agricultural environment, it is quite possible that the same transaction particularly with the same mechanism can not be applied for the development of agricultural sector of each and every state. It may be more beneficial for those countries that have the same agricultural climate, values and norms.

[175]Muhammad Ridhwan Ab. Aziz and Muhammad Mohamad Yusoff, *Financingfor Agro Projects in Islamic Banks,* 2013 International Conference on Agriculture and BiotechnologyIPCBEE vol.60 (2013) © (2013) IACSIT Press, Singapore DOI: 10.7763/IPCBEE. 2013,v.60. 3.

may not be suitable for other others parts of the world. Keeping in view the concept of globalization of the world, the generalization of any type of research is now an indispensable quality that cannot be compromised.

Ahmad Kaleem[176] is also a contributor of work for the development of Islamic agricultural finance.[177] He has urged the Islamic banks and other Islamic financial institutions (in Pakistan) not to focus on consumers but to cooperate financing in regard to the agricultural sector and particularly that of rural areas. According to Kaleem, the agricultural finance facility is only provided to a small number of farmers by financial institutions (in urban areas) while the majority of farmers live in rural areas and, they are mostly ignored in this regard. While referring to a survey conducted by the Lahore School of Economics, he says that the *Salam* transaction can be applied as an alternate to interest based loans for the development of the agricultural sector both for crop and non-crop activities. In addition, he proposes two efficient models for the development of agricultural sector. The first is a partnership based model where the Islamic banks and other Islamic financial institutions appoint an intermediary as their agent to collect crops, sell the same in the local market, and return shares of the Islamic financial institutions according to the agreement. The second model is based on diminishing *Mushārakah* where the Islamic banks deal directly with farmers without any agent. In the researcher's point of view, both of these proposed models can prove to be very helpful for the development of the agriculture sector particularly that of rural areas if applied in their true spirit, avoiding the usual profit maximization purpose of financial institutions. The research work does have some major deficiencies however. It concentrates more on local farming of the agriculture sector and does not pay any attention to other sectors of agriculture like livestock, poultry farming, dairy farming, horticulture, or fish farming; though this the title of his work alludes to covering of agriculture as a whole (i.e. outlook for Islamic Financing of Agriculture). This shortcoming decreases the scope of the work for the agricultural sector as a whole. Similarly, some of the reported results from the survey seem very satirical. For example, it is reported that 48.9% of the

---

[176]Ahmad Kaleem is an associate professor in Lahore School of economics. His area of specialization is Islamic banking and finance. The author has written so many articles on various burning issues of Islamic banking and finance.

[177]Ahmad Kaleem, *Outlook for Islamic financing of agriculture*, March 2007, http:// www.pakissan.com/.../outlook.for.islamic.financing.of.agriculture.shtml(accessed: 15thFebruary , 2014).

respondents are aware of Islamic banking. However, other experts have a completely different finding where majority the population in the country is not aware of Islamic banking. In this regard, the Governor of the State Bank of Pakistan (SBP) states,

> A significant proportion of Pakistanis were either unaware of Islamic banking or had some misconceptions about its functioning. The SBP had mobilized the industry to launch a nationwide mass media campaign to create awareness and address the perception issues.[178]

Bernardo Vizcaino's report also confirms this lack of awareness by stating, "Pakistan's central bank has launched a mass media campaign to raise awareness and acceptance of Islamic finance among consumers in the world's second most populous Muslim country".[179] This shows that majority of the population in the country is unaware of Islamic banking and finance and farmers, therefore, being a large part of the population will have the same lack of awareness.

Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq and Malka Yasmeen contributed to the works on Islamic banking and its role in the development of the agricultural sector both for crop and non-crop activities.[180] The research of these scholars is shown to be more authentic because they utilized a proper methodology for the investigation of the issue. Their respondents included the entire group of stakeholders related to the issue under study comprising customers of the bank, customers who are not availing services of Islamic banks, and the managers of the financial institutions. In short, they examined the issue from all directions. Their findings indicate that Islamic banks and other Islamic financial institutions can provide easy financing to farmers through the use of various modes of Islamic commercial law i.e. *Mushārakah* (partnership), *Murābahah* (sale with profit), *Ijārah* (leasing), and *Salam* (advance payment sale). They further note that various working capital can also be

---

[178]Official Newsletter of Pakistan Business Forum, October 2013, Governor SBP Launches Islamic Banking MediaCampaign, p.4, http:// www.pakbforum.com/admin/download/October13.pd(accessed: 15thFebruary , 2014).
[179]Pakistan Launches Media Campaign to Boost Islamic Finance, Reuters, Reported by Bernardo Vizcaino and Edited by Eric Meiger and Michael Perry, Dated on Fri Jul 19, 2013 11:48am IST. http:// in.reuters.com/.../islamic-finance-pakistan-idINDEE96I04320130719 (accessed: 16th February , 2014).
[180]Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq, Malka Yasmeen, *Role of Islamic Banking in Agriculture Development in Bahawalpur, Pakistan* ,International Journal of Learning & Development ISSN 2164-4063 2012, vol. 2, no. 3.

provided by using the same and some other transactions of Islamic finance. Instead of numerous benefits, the authors have left some areas in their research for critical analysis. For example the focus of the study is restricted to an important district of Southern Punjab Pakistan (i.e. Bahawalpur). This restricts the practical utility of the work for the development of the agricultural sector in other parts of the country predominantly for those regions that have a different geographical and ecological environment. The political and social environment can also cause a drastic change in the operation of agricultural finance from one region to another. Similarly, their sample size of 120 respondents may not be sufficient for the extraction of accurate findings. In addition, it is not clear whether the respondents belong to the lower, middle, or upper class of farmers as each of these classes has a different approach to the role of Islamic banking in the development of the agricultural sector both for crop and non crop activities.

Naeem Ur Rehman Khattak and Anwar Hussain are among such scholars who have presented comprehensive works on the issue of agricultural credit.[181] The have critically revised those principles that are followed by Islamic banks for the provision of agricultural credit. In their view, Islamic banks can easily play a role in the development of farming sector in Pakistan through the inculcation of various techniques of Islamic finance like *Mushārakah* (partnership), *Murābahah* (sale with profit), *Ijārah* (leasing)and its various kinds, *Salam* (advance payment sale), and *Istisnā‘* (manufacturing contract). They agree that agricultural support of Islamic banks must be asset based and money should not be used for the same purpose. They further add that all transactions that are involved in agricultural credit must be free from any uncertainty that is prohibited by *Sharī‘ah.* Instead of the vital role that can be played by this research in the development of agricultural credit, there are some issues that must be elaborated for its further improvement. For example, the title of the research, “A Review of the Principles of Islamic Banking System (IBS) for Agriculture Credit (AC), Pakistan” seems to go against the writers’ claim that all types of dealings between Islamic banks and farmers must be asset based. It is obvious that by using the term “credit” a loan transaction cannot be changed into an asset based transaction.

---

[181]Naeem Ur Rehman Khattak Khattak and Anwar HussainHussain, *A Review of the Principles of Islamic Banking System for Agriculture Credit, Pakistan*, Institute of Development Economics Islamabad Pakistan 2006, MPRA Paper No. 42038, posted 18. October 2012.

The role of Islamic finance in the growth of the agricultural sector is also discussed by Kazem Sadr, Mohammad-Ali Kafaie, and Bahram Haidari.[182] The main objective of their research is to develop a model to measure the effectiveness of financial services on the value addition of the agricultural sector. In an ancillary to this work, the authors' other purpose is to see the effect of those changes which radically occurred in the banking and financial system on the development of agricultural sector.[183] Their findings show that by changing the banking system from interest based transactions to interest free transactions brought about a remarkable development in the agricultural sector in all its vital branches. This contribution is equal to the contribution of the labor force in the same sector. The work of such scholars is not without some flaws. The work is purely related to the role of Islamic finance in Iran's agricultural sector and, hence, the findings cannot be applied to other countries' agricultural sectors. Similarly, the title of the work is related to the contribution of Islamic finance in the development of the agriculture sector while the content concentrates on the effects of drastic changes that occurred in Iran as related to the policies of Islamic banking and finance. However, this issue is further extended by the scholars to the growth of the agriculture sector.

Saeed Yazdanī's research was a vital contribution to the growth of the agricultural sector through Islamic commercial transaction.[184] He found that Iranian farmers, predominantly those who belong to the lower class of farmers, are very hesitant about securing credit from conventional financial institutions. He explained that there are many explanations for this sort of

---

[182]Kazem Sadr, Mohammad-Ali Kafaie, Bahram Haidari, *Islamic Agricultural Finance and Growth*, http:// ier.ut.ac.ir/?_action=showPDF&article=31007&_ob...full. (accessed: 16th February , 2014).

[183]In June 1979 a drastic change was made in the banking and finance sector of Iran when all Banks were nationalized and their rules and regulations were replaced by the principles of Islamic banking and finance. It means that the former interest based system was replaced with interest free based banking and finance. The banks were asked to restrict their operation to trade based activities, provision of services, collection of deposit etc. In addition to this, in 1983 the Islamic Banking Law of Iran was passed by the Islamic Majlis of Iran that obliges all Islamic banks and other Islamic financial institutions to participate in those commercial transactions which are interest free .All these steps are taken as interest and usury is strictly prohibited by the Holy *Qur'ārn* and sunnah of the Holy Prophet(SAM) …………..(see for further details S.Husain Ashraf , Mr. Ali Alizadeh Giashi, *Islamic Banking in Iran -Progress and challenges*, Kuwait Chapter of Arabian Journal of Business and Management Review vol. 1, no.2; October 2011.

[184]Saeed Yazdanī, *An Evaluation of Agricultural Credit System in Iran, Savings and Development*, Giordano Dell-Amore Foundation, vol. 29, No. 2 (2005), pp. 117-132.

hesitation. First, they fear that their fields may not yield crops at harvesting time, leading to a situation where they may not be able to repay the money on time to the financial institutions. Additionally, Muslims are strictly prohibited by *Sharī'ah* to secure a loan on an interest basis and, therefore, these poor farmers avoid interest-based loans. Saeed Yazdani argues that small farmers prefer to secure free interest loan from financial institutions, however, because of some factors, the large farmers get more of the share in the available funds. Yazdanī's work is more precise due to his use of a proper methodology for the investigation of the issue. His survey is conducted carefully and the questions were developed appropriately for the task of assessing farmers' attitude toward various types of loans. The research clearly points out that Islamic agricultural finance is the preferred credit system for the development of the agriculture sector in Iran. However, the study is very limited as it is primarily related to the agricultural credit in Iran and, therefore, the recommendations may not be suitable for other conventional and Islamic financial institutions existing in various parts of the world.

As mentioned earlier, the majority of farmers belong to the lower class of the society.[185] Additionally, a major portion of these farmers lives in rural areas of their corresponding countries.[186] The study of Badawi B. Osman reflects contribution for the development of such lower class of farmers.[187] His work examines the experience of the National Bank in Sudan

---

[185]See for example Sohail Jehangir Malik, Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, Vol. 38, No. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716; Dale W. Adams, Agricultural Credit in Latin America: *A Critical Review of External Funding Policy*, American Journal of Agricultural Economics,Vol. 53, No. 2 (May, 1971), pp. 163-172; *Strengthening Agricultural support Services For Small Farmers*, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

[186]It is a matter of fact that majority of farmers in developing countries were living in rural areas. For instance in case of Pakistan 62% of the country's population was living in the rural areas and directly or indirectly allied with agriculture as their livelihood(Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan Ministry of Finance, Chapt.2,p.13 http://www.finance.gov.pk/(accessed January,2013). The case of Bangladesh was not different where the population of rural areas reached to 80% of the whole inhabitants(Strengthening Agricultural support Services For Small Farmers, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004).An empirical research showed the same fact regarding the state of Ghana where half of the population in rural savannah zones was extremely poor(WilliamF. Steel,David O. Andah, *Rural and Micro Finance Regulation in Ghana: Implications for Development and Performance of the Industry*, Africa Region Working Paper Series No.49 June 2003ttp://www.worldbank.org/afr/wps/index.htm. (accessed Deceber 25, 2012).

[187]Badawi B. Osman, *The Experience of the Sudanese Islamic Bank in Partnership (Mushārakah) Financing as a Tool for Rural Development among Small Farmers in Sudan*, Arab Law Quarterly, Vol. 14, No. 3 (1999), pp. 221-230.

regarding its operations in various rural parts of the country which are mostly ignored by the financial institutions. He points out that the traditional farmers of such areas can play a vital role in the increase of agricultural production and can, thus, excel the country's economy in a progressive direction. These goals can be achieved with the condition that Islamic banks and other Islamic financial institution provide financial facility on the basis of true Islamic commercial transactions. *Mushārakah* (partnership), an important mode of Islamic finance, can be used more effectively in this relationship. Osman further adds that if the agricultural partnership is properly guided and supervised then it can yield more returns as compared to other modes of Islamic finance. Moreover, this mode is more suitable for farmers in the sense that they are not required to provide collaterals or other forms of securities that mostly act as a hurdle for them to secure financial backing. The work of the author is more reliable in the sense that he has involved the execution of many agricultural projects. His strong recommendations provided at the end of his work reflect the same. However, his study revolves around *Mushārakah* and does not take into consideration other modes of Islamic commercial law like *Murābahah* (sale with profit), *Ijārah* (leasing), *Salam* (advance payment sale), and *Istisnā'* (manufacturing contract) and, therefore, the research is very limited in terms of its content.

The role of *Mushārakah* in the development of the agricultural sector of Iran is also discussed by Kazem Sadr[188] with minute details.[189] In his view the Agricultural Bank of Iran has achieved the intended results through the use of *Mushārakah* in agricultural sector both for crop and non-crop activities. Therefore, funds are now provided to all class of farmers through this mode of Islamic commercial law with a minimal transactional cost. The transaction can be made more profitable if the Islamic banks and other Islamic financial institutions manage an effective and continuous supervision along with technical assistance and a proper mechanism for the

---

[188]Kazem Sadr is formerly professor in the department of Economics, School of Economics and Political Science., Shahid Beheshri University Tehran. The author has a great contribution to the existing body of knowledge related to Islamic economics, Islamic banking and Islamic finance. He teaches various subjects like Economics, Economics Theory, Agriculture and Resource Economics, Islamic Finance etc. His writing on agricultural finance is more practical in nature owing to the fact that he remained a committee member at Agriculture Bank of Iran. The learned author has two books and nearly fourteen research articles published in various academic journals……..see for details http:// www.inceif.org/faculty-members/emeritus-prof-dr-seyed-kazem-sadr-2(accessed: 20th February , 2014).

[189]Kazem Sadr, *The Role of Mushārakah Financing in the Agricultural Bank of Iran*, Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 245-256.

observation of the provided funds. He further adds that all these arrangements will require the financial institutions to bear additional costs of operation but it will also turn the transaction into a profitable investment. Despite of the contribution in Islamic agriculture finance, this work can also be critically analyzed. The author urges the Islamic financial institutions to go for active supervision of the funds which is almost impossible. If the recommendation is followed, the Islamic bank will not only bear the additional operation costs but it will also require more human resources for the accomplishment of the tasks. This situation may lead the Islamic banks and other Islamic financial institutions to rethink financing agriculture particularly through *Mushārakah*. Similarly, the findings of the work are based on presumptions of the author and his expertise along with statistical data from some authentic sources. But if the findings are further tested with some contemporary reliable research tools like surveys and questionnaires, it would further strengthen the study and make it more significant in future research.

The research of Haroon Rasheed and Muhammad Mudassar[190] is valuable as compared to other studies on the issue as they develop practical innovative models that can be used by Islamic banks and other Islamic financial institutions for the development of the agriculture sector in Pakistan. In their view, *Salam* (advance payment sale) can be used as an alternate mode to interest based loans for financing agriculture particularly in Muslim countries where the farmers prefer to avoid the element of interest. They attach some extra benefits to this Islamic mode of finance as compared to other modes of Islamic finance. In their view, the *Salam* transaction is advantageous to both the farmers and banks. It is advantageous for the farmers in the sense that they acquire the price of the commodity in the beginning of a season which they use for the realization of their basic agricultural needs. Similarly, they get relief from the transportation cost and also shift the risk of fluctuation to the banks as a buyer. It is favorable for Islamic banks and other Islamic financial institutions in the sense that they acquire the commodity at a lower price. Similarly, they also transfer the business risk to the farmers as they have to provide the determined quality and quantity of the commodity at a given time mentioned in the contract.

---

[190]Haroon Rasheed ,Muhammad Mudassar, *Research on Innovative Models of Islamic Banking Product for Pakistani Farmers*, Proceedings of the 7th International Conference on Innovation & Management,http://www4.pucsp.br/.../26_Research%20on%20Innovative%20Models%20of(accessed:22nd February , 2014).

While concentrating on the contract of *Salam*, Rasheed and Mudassar present two models that can be applied to the agricultural sector at a large scale. The first model is structured in such a way that the Islamic bank appoints an intermediary as its agent to collect the *Salam* commodity from the farmers, sells the same in the local market, and hands over the price to the financial institution. In the second model, the Islamic bank forms its own subsidiary that regulates the relationship between the bank and farmers. The financing facility is also provided to the farmers on the recommendation of such a subsidiary. The responsibility of a subsidiary is to provide technical advice, monitor the advanced loan and to collect the crops at the harvesting cycle. This model is more favorable for farmers as compared to the previous one in the sense that the subsidiary has the additional responsibility to provide basic agricultural inputs. This will further boost the usefulness of the model for the true development of the agriculture sector.

Ahmad Kaleem and Saima Ahmad have also presented their work on the application of *Bay'Salam* to the agricultural sector in Pakistan.[191] The study is conducted to explain the bankers' perception regarding this transaction and its use for agricultural finance. In the authors' view; the financial institutions are confused about the application mechanism of *Bai' Salam* for the development of the agricultural sector both for crop and non-crop activities. This confusion stems from improper land record maintenance by the Revenue Department, illiteracy of the farmers[192] and various government policies regarding the provision of credit to the agricultural sector. The study can be used effectively by Islamic banks and other Islamic financial institutions to revisit the existing mechanism of the transaction and make the required changes for better results in the future. Notwithstanding the importance of the work, it can be critically analyzed from two angles. First, the claim that financial institutions are puzzled about the existing structure of *Bai' Salam,* particularly in agricultural finance, is not based on logical grounds as this transaction has been recognized by *Sharī'ah* in order to help out the farmers in the beginning of a season.[193] It means that the transaction is structured in such a way that can achieve the

---

[191]Ahmad Kaleem and Saima Ahmad, *Bankers' Perception Towards Bay' SalamMethod for Agriculture Financing in Pakistan*, Journal of Financial Services Marketing 15, 215-227 (December 2010).

[192]Mohsin Ali, *Agriculture Problems in Pakistan and Their Solutions*, March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013).

[193]Salam was allowed by the Holy Prophet (SM) subject to certain conditions. The basic purpose of this sale was to meet the needs of the small farmers who needed money to grow their crops and to feed their family up to the time of

intended results. If it is so then it is very difficult to accept the presumption presented by the authors. Second, the claim that the Revenue Department in Pakistan does not maintain proper record of the land owners may be true in the rural areas of the country like in the North; however the same presumption for urban areas is not correct. Land records are very properly maintained by the concerned department in urban areas as the property is very valuable in such areas and properly owned by individuals.

Ahmad Kaleem and Rana Abdul Wajid also provide a good work on the contribution of *Bay'Salam* on the development of the agricultural sector in Pakistan.[194] They discuss how this mode of Islamic finance can be applied to fulfill requirements of farmers particularly in the crop sector. The methodology employed by these scholars has produced reliable findings from the field. According to their results, 70% of farmers apply for agricultural credit to fulfill their various immediate needs to buy basic agricultural inputs, to pay for labor, and to rent machinery. These farmers repay the advanced loan at the end of the harvesting cycle through the sale of their yields. They further explain that the majority of farmers like to purchase the basic agricultural inputs with cash rather than on a delayed payment basis, believing that they can save up to 25% in costs. Additionally, the authors present three possible models of *Bay'Salam* for the practical application to the agricultural sector. Besides the advantages that the work has for the expansion of the agriculture sector in Pakistan, it also contains some weaknesses. For example, the work is purely related to the agriculture sector in Pakistan where majority of Islamic banks and other Islamic financial institutions provide credit to the agricultural sector through other modes of Islamic finance like *Murābahah* (sale with profit) and *Mushārakah* (partnership) while the *Salam* transaction is not normally preferred. According to the Economic Survey of Pakistan 2009 and 2010, *Murābahah* has the largest share in the market of Islamic banking followed by *Ijārah*

---

harvest. After the prohibition of *Ribā* they could not take usurious loans. Therefore, it was allowed for them to sell the agricultural products in advance. Similarly, the traders of Arabia used to export goods to other places and to import some other goods to their homeland .They needed money to undertake this type of business. They could not borrow from the usurers after the prohibition of *Ribā* .it was; therefore, allowed for them that they sell the goods in advance .After receiving their cash price, they could easily undertake the aforesaid business(See for example his work: Muhammad Taqi Usmani, An Introduction to Islamic Finance, p.186.

[194]Ahmad Kaleem, Rana Abdul Wajid, (2009) "*Application of Islamic Banking Instrument (Bai Salam) for Agriculture Financing in Pakistan*", British Food Journal, Vol. 111 Iss: 3, pp.275 – 292.

(leasing), *Musharakah, Mudarabah,* and, lastly, *Diminishing Musharakah*.[195] This report reduces the importance of the work for the Islamic financial institutions in Pakistan. Similarly, the work is limited as it covers a specific sector of agriculture like local farming and does not take into consideration other sectors of agriculture. However, being very flexible in terms of its rules and regulations, the transaction of *Bay'Salam* can be effectively applied for the development of all these sectors. For example, this transaction can be used by the Islamic banks and other Islamic financial institutions to fulfill basic needs of poultry farming through the provision of funds at various cycles of poultry farming.[196] It can, likewise, be applied for the development of fish farming in the country.[197]

Islamic banks and other Islamic financial institutions can play a vital role in the development of the agricultural sector both for crop and non-crop activities. This role may differ from state to state and region to region, depending upon on various factors like the active or passive interest of the concerned government in the augmentation of agricultural sector, the overall political and economic situation of the country, the literacy rate of the people, particularly that of farmers, the profit potentials of agricultural activities, and environmental and geographical positions of the farming area for which the financing facility is needed. The Islamic banks and other Islamic financial institutions take all these factors into consideration before

---

[195]Economic Survey of Pakistan 2009-10.

[196]There are some basic needs of poultry farming which can be easily fulfilled through *Bay' Salam's* funds. These needs include construction of broiler, layers, breeder and hatchery farms, feed mills, control sheds, automatic drinkers or tube feeders, generators, ventilators, tables or breeders eggs storage refrigeration plants, purchase of machinery or equipments for poultry farming, hatchery and feed mill, transport vans, eggs and poultry carrying vans, distribution vehicles such as motorcycles, pickups, deep freezers, slaughtering, and defeathering machines and etc.

[197]Like other sub sectors, fish farming is an important sub sector of agriculture and plays an important role in the economic stability of a country. There is a great pressure of demand for beef, mutton and poultry which is reduced to a great extent by modern fisheries. But regrettably a due attention is not given to this sector, predominantly in the subcontinent that has a great potential for this sector. It has different needs that can be contented through the provision of funds by the way of *salam* i.e. for instance such funds can be used for the purchase of motorboats, fishing trawlers, purchase of marine engines, replacement of engines and spare parts, construction of cold storage by fisherman with the use of insulation materials or sheets for walls or roof, purchase of other deck equipments like winch, wire rope, gallows,net handlers, navigational lights, communication equipments, radars, life jackets, life boats, anchors, direction finders (compasses), echo sounded (fish finders), life buoys, insulation materials, purchase of nets trawlers, purchase of chilling or freezing plants, fish storage center, fish or shrimp hatcheries, purchase of mobile insulated, pickups, Vehicles and etc (See for further details Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transaction*, 1st Edition 2011.,Lambert Academic Publishing, Germany).

offering financing for agriculture and its various sectors.

The influence of Islamic banks on the development of the agricultural sector is comprehensively discussed by Muhammad Ali Alula Al-Hashmi in his work.[198] In his work, the author presented the past role of Islamic banks in the growth of the agricultural sector in Sudan from the various available data. He adds that, despite Islamic banking's willingness to play its role in the development of the agriculture sector, many farmers are dissatisfied with their job in this regard. Islamic banks and conventional financial institutions had a tendency to provide short term loans for the purpose of earning huge profits. However, the public and state owned banks have played a satisfactory part in this new relationship by providing nearly 29% of their loans for the growth of the agricultural sector. According to Al-Hashmi, it is an extremely difficult job for a farmer to secure an interest based loan from a financial institution. There are many reasons for this sort of discrepancy. The first is the limited access to financial institutions in rural areas. Second, these institutions do not advance loans without minimal size collateral and other securities. As a result to such hurdles, the farmers in rural areas resort to money lenders who usually provide loans at a high interest basis. The author also discusses in detail how the arrangement of *Mudārabah* can be used effectively for financing agriculture. The study could be used by the Islamic banks and other Islamic financial institutions as a useful guideline in framing their policies for the development of the agricultural sector. However, the work can also be criticized. As the title of the work suggests, the author must discuss the influence of the Islamic banking sector in regard to the expansion of agriculture, avoiding topics such as the general principles of marketing in Islam, Islamic economic ideology, detailed discussion of *Mudārabah,* etc. Similarly, the influence of Islamic banking should be argued through the discussion of all those modes of Islamic commercial law which can be easily applied and used for financing agriculture like *Murābahah, Ijārah* (leasing), *Mushārakah, Mudārabah,* and *Diminishing Mushārakah*. Moreover, the study is solely conducted in Sudan which additionally limits its application.

---

[198] Muhammad Ali Alula Al-Hashmi, *The Influence of Islamic Banking on Agricultural Development in Sudan*, A plan B Paper, Submitted to Michigan State University, Department of Agriculture Economics 1989. http://ageconsearch.umn.edu/bitstream/10994/1/pb89al02.pdf(accessed: 28th February , 2014).

2.2. Conclusion

In the last two and half centuries many had written about agricultural finance. They discussed both formal and informal institutions that could provide financial support and assistance for the expansion of agriculture. That work, however, in the beginning was predominantly related to informal sources of funding such as personal loans between family and friends as these were more prevalent among farmers for several reasons e.g. familiarity of farmers with these sources, simple procedure, easiest accessibility, low transaction cost, flexible repayment etc. The contributors' list of such works include Luc Tardieu, Laval, Abdullah, George Owuor, A.O. Shem, Calum G.Turvey, Rong Kong, Catherine Guirkinger, Walter Schaefer-Kehnert, John D. Von Pischke, S. Tilakaratna, Sisay Yehuala, Rakesh Mohan, Manojit Bhattacharjee and Meenakshi Rajeev etc . All these scholars studied various aspects of informal agricultural finance critically and did not concentrate on whole mechanism of informal sources. For instance, George Owuor and A.O. Shem, the most prominent agricultural economists, worked on the importance of informal sources in the enrichment of agricultural production, Laval, Abdullah, Calum G.Turvey and Rong Kong discussed the importance of informal finance in the development of rural agricultural sector, Tardieu's study covered various issues related to informal financing sources with evidence from the ground authenticity, Catherine Guirkinger worked on risky nature of the informal agricultural credit system etc. Due to the inherent defects in informal agricultural finance like short terms, small amounts, and the exploitive nature of the system; experts of agricultural finance introduced scholarly work on formal credit; a new system that was characterized uniquely by its well-built nature, well organized structure and composition, obvious aims and objectives, ease in procedure and documentation, and flexibility in repayments. Nevertheless, in the beginning such work remained introductory, covering all issues related to the provision of credit service in a short and comprehensive way. They evaded going into the details of various issues either deliberately or due to the newness of the field as many dimensions were not understood. These scholars include Walter Schaefer-Kehnert, John D. Von Pischke, Richard L. Meyer, Gonzalez-Vega, Khalid S. Mohamed, Andrew E. Temu, Robert Peck Christen, Douglas Pearce, Calvin Miller, Ivana Gegenbauer, Betty Kibaara, James Nyoro, Calvin Miller, Tushar Pandey, Martin Prowse, Mare Hudson, Sisay Yehuala, Samuel Kwaku Obeng, Johan F. M. Swinnen, Hamish R. Gow, Kewal Kumar, Atul Gambhir, S. S. Hosseini, M.

Khaledi, M. Ghorbani, B. G. Brewin, Irma C. Corales, Carlos E. Cuevas, Harsha de Silva, Dimuthu Ratnadiwakara, Jason Clay, Todd Benson, Stephen L. Kirama, Onesmo Selejio, M. Ghaffar Chaudhry, Shamim A. Sahibzada etc. The work of these scholars covered various aspects of formal credit and did not discuss the formal credit system as a whole. The main feature of such formal credit system was interest, a prohibited concept in *Sharī'ah* (Islamic law). Hence, Muslim farmers had to go for identifying other sources of financing recognized by Islamic commercial law. The classical and contemporary Muslim jurists had attributed much importance and examined these alternative funding sources in great detail. This list of these scholars included some well renowned classical Muslim jurists like Imām al-Shawkānī, Imām al-Kāsānī, Ibn Qudāmah al-Maqdisī, Abū al-Walīd Muhammad ibn Ahmad ibn Rushd, Imām Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī, Ibn ʿĀbidīn etc. The majority of these jurists had devoted separate chapters of their work to the concept of *Muzāraʿah*, *Musāqah*, and *Salam*; the various financing modes of Islamic commercial law for the development of agricultural sector. However, other modes of Islamic finance like *Mushārakah, Murābahah*, *Ijārah*, *Salam*, and *Istisnā'* were not discussed in the perspective of agricultural finance. This gape was covered by contemporary Muslim/ non-Muslim scholars like Muhammad A. Gulaid, Maulana Muhammad Taqī ʿUthmānī, Brian B. Kettell, Monzer Kahf and M. Fahīm Khan, Magda Ismail Abdel Mohsin, Laurence M. Crane and David J. Leatham, Adam B. Elheraika, Ali Yasserī, Saeed Yazdanī, , Hassan Yusuf Davood, Abdul Aziz Muhmmad Rizwan, Al-Hashimi and Muhammad Ali Alula, Muhammad Ridhwan Ab. Aziz, Muhammad Mohamad Yusoff, Ahmad Kaleem, Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq, Malka Yasmeen, Naeem Ur Rehman Khattak, Anwar Hussain, Kazem Sadr, Mohammad-Ali Kafaie, Bahram Haidari,Badawi B. Osman, etc. Some of these scholars discussed Islamic agricultural finance comprehensively (like Muhammad A. Gulaid, Hassan Yusuf Davood etc) while others covered its various aspects (like Muhammad Mohamad Yusoff, Ahmad Kaleem, Badawi B. Osman etc).

Agriculture plays an important role in the development of a society and its nourishment. It is not only a source of food for the human being but also provide them employment and business. Being an important sector, each county and its concerned government has concentrated on the development agricultural sector more as compared to other sector. In Pakistan the same

approach is mode and various measures have taken for its development, both in crop and non crop activities. For instance, the State Bank of Pakistan has opened a separate department in order to enhance role of the financial institutions in the development of agriculture and its various sub sectors. The literature review shows that classical and contemporary Muslim and non-Muslim jurists have devoted their time for the purpose to investigate various issues related to agricultural finance. They thoroughly discuss the issue of interest, collaterals, securities, subsidies, credit worthiness, reduction of transactional cost in agricultural credit, decrease of documentation, etc with minute details. Some of them have developed various models for financing agriculture, having viable nature for all stake holders. i.e. the financial institutions, farmers, share holders etc. The work of Laurence M. Crane and David J. Leatham, Adam B. Elheraika, Ali Yasserī, Saeed Yazdanī, ,Hassan Yusuf Davood, Abdul Aziz Muhmmad Rizwan,Al-Hashimi and Muhammad Ali Alula,Muhammad Ridhwan Ab. Aziz, Muhammad Mohamad Yusoff, Ahmad Kaleem, Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq, Malka Yasmeen, Naeem Ur Rehman Khattak, Anwar Hussain, Kazem Sadr, Mohammad-Ali Kafaie, Bahram Haidari, Badawi B. Osman, etc is very remarkable in this regard.

CHAPTER 3

AN OVERVIEW OF AGRICULTURAL FINANCE IN PAKISTAN

3.1 Introduction:

The majority of farmers in Pakistan has a low socio-economic status and, therefore, live below the poverty line.[199] Statistics show that seventy five percent of the population in Pakistan is directly or indirectly related to agriculture.[200] Farmers frequently need of money at different phases of the harvesting cycle to accomplish various agricultural requirements both for crop and non-crop activities. These requirements can be fulfilled through the availability of financing facility which can be provided by two sources i.e. informal sources and formal sources. The former sources are very traditional in nature and exist since independence of the country. In Pakistan these sources are typically provided by relatives, friends, neighbors, local money lenders, village shopkeepers, traders, and commission agents.[201] The formal sources in Pakistan, on the other hand, are highly organized in nature and generally provided by conventional banks, conventional, Islamic financial institutions, etc. These sources also include in broad sense NGOs (Non Government organizations) and some international bodies. In the modern times, these formal sources are used excessively for the development of agricultural sector both in crop and non-crop activities. In the following line both the informal and formal will be discussed in details.

3.2 History of informal Agricultural Finance in Pakistan:

The history of informal sources date back to the beginning of agricultural activities around the globe. Informal sources of financing agricultural activities have existed in society from times immemorial. For example in China tradition, informal sources have shaped modern informal finance structure after independence. Turvey and Kong have the same opinion while stating,

---

[199]Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, vol. 38, no. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999)

[200]Fahim Patel, *Agriculture and Its Problems in Pakistan*, Guess Papers,http://www.guesspapers.net › Class XII › XII Commercial Geography(accessed: 5th April 2014).

[201]Muhammad Khalid Bashir and Muhammad Masood Azeem,*Agricultural Credit in Pakistan : Constraints and Options*,Pak. j. life soc. sci. (2008), 6(1),pp. 47-49.

> While Chinese culture transitioned from a state of civil war and the declaration of the Peoples Republic of China, through the Great Leap Forward and the Cultural Revolution little is known about how informal markets transitioned to their present day forms".[202]

Jones, argues that the history of informal finance in India is not different from that of the People's Republic of China when he says, "From the 1950s up to the early 1990s the All-India data shows an ever-declining share of informal credit in the total outstanding debt of rural households"[203] Both these statements clearly indicate that informal sources of financing provide financial support to the poor sectors of society since long tome and is a vital factor in the development of agriculture and its sub-sectors.

In Pakistan the history of informal agricultural finance started since its independence in 1947. Researchers have traced back this practice in history to the 19th century. Adnan Qadir explains that informal sources existed in the province of Punjab and the local proprietors were indebted at very high level.[204] He further added that there were 40,000 money lenders existing only in the province to provide financing facility. However, majority of such loans were spent on unproductive activities, such as, to pay off the compound interest or bear the extravagant expenditures of marriage ceremonies etc; and only small portions, about five percent of the loan was used for the development of land which included agriculture. The unprofitable management of loans affected the agricultural production rate and caused severe food shortage at the national and international level. The money lenders were also available in rural parts of the country and had played a vital role there too. Mir Kalan Shah, Humayun Khan, Jehanzeb,

---

[202]Calum G. Turvey, Rong Kong, *Informal Lending Amongst Friends and Relatives: Can Microcredit Compete in Rural China?*Paper Submission for CERMi First European Research Conference on Microfinance 2-4 June 2009 Brussels, Belgium Wednesday, March 25, 200**.**

[203]J. Howard M. Jones, *Informal finance and rural finance policy in India: historical and contemporary perspectives*, Contemporary South Asia, vol.16, issue 3.

[204]Adnan Qadir ,*A Study of Informal Finance Markets In Pakistan*, with a study of SMEs by Dr. Faisal Bari and Adeel Faheem and a survey by the Punjab Economic Research Institute, Pakistan Microfinance Network ,December 2005,www.microfinanceconnect.info/assets/articles/informal.pdf(accessed: 13th April 2014).

Zalakat Khan contend that such credit facility in rural areas was provided by relatives, friends, landlords, shopkeepers, and commission agents.[205] They further explain that most of these sources of informal finance exploited the poor and the loan facility was provided on the fulfillment of two conditions, that

1. the farmer should pay a high interest rate.
2. the farmer would sell agricultural products to money lenders at the end of the harvesting cycle.

Both these conditions show the exploitive nature of such credits. Besides, there are some other types of exploitation highlighted by various scholars in their work.[206]

In addition to the defects in formal sources of agricultural credit, the farmers found some major advantages in informal agriculture finance. The following lines would discuss all these with minute details.

3.3 Merits of Informal Sources of Agricultural Finance (Pakistani Perspective):

As mentioned earlier, the majority of farmers in Pakistan are using informal financial sources for the fulfillment of their agriculture requirements. This propensity is owing to the following facts.

3.3.1 Good Knowledge of Local Farming Requirements

In Pakistan informal credit is usually provided by relatives, friends, money lenders, and tradesmen.[207] Some other scholars have the same view.[208] They have an ample knowledge about basic agriculture requirements of the local farming. As an out come of this knowledge, they provide adequate funds to the local farmers for the fulfillment of such requirements. The formal

---

[205]Mir Kalan Shah, Humayun Khan, Jehanzeb, Zalakat Khan,I*mpact of Agricultural Credit on Farm Productivity And Income of Farmers in Mountainous Agriculture in Northern Pakistan: A Case Study of Selected Villages in District Chitral*, Sarhad J. Agric. vol.24, no.4, 2008.

[206]All these exploitations will be discussed in details under the heading of "Disadvantages of Informal sources in Pakistan".

[207]Winfried Manig ,*The Importance of the Informal Financial Market for Rural Development Financing in Developing Countries: The Example of Pakistan*, The Pakistan Development Review 35 : 3 (Autumn 1996) pp. 229—239.

[208]See for example the work ofMuhammad Khalid Bashir and Muhammad Masood Azeem, Agricultural *Credit in Pakistan : Constraints and Options*,Pak. j. life soc. sci. (2008), 6(1), pp47-49.

sources on the other hand, are very deficient in this regard. For instance, Zarai Taraqiati Bank Limited (a leading and specialized bank for the development of agriculture and its sub sectors) and other commercial banks provide small loans in agriculture credit as compared to other sources. The statement of Ahmad Kaleem supports this view,

> "Some 47.11 per cent farmers meet their financial needs through borrowing from middlemen, 22.80 per cent from friends and neighbors, 11.55 per cent take advance against crops and 10.33 per cent from banks. Small minority (8.21 per cent) of farmers use their own savings"[209]

The statement of this well renowned researcher clearly indicates the level of interest having by the formal financial institutions in the development of agriculture sector and the amount of funds provided by them for the growth of the same. The State Bank of Pakistan recognizes this fact in its hand book issued for financing rural and agriculture finance, by stating

> "In Pakistan, agricultural credit market consists of formal and informal providers of credit. Formal lenders are: specialized banks like Zarai Taraqiati Bank Ltd. (ZTBL) and Punjab Provincial Cooperative Bank Ltd. (PPCBL) and commercial banks, while the latter comprises of illegal money lenders, friends and relatives, village shopkeepers and commission agents. The predominant share of credit is provided by the informal sources of credit in the country."[210]

A comprehensive picture of the whole discussion can be easily found in the following table.

Supply of Agriculture Credit by Institutions Rs .In Billion

[209]Ahmad Kaleem, *Outlook for Islamic Financing of Agriculture*, March 2007, http:// www.pakissan.com/.../outlook.for.islamic.financing.of.agriculture.shtml(accessed: 15thFebruary , 2014).

[210]*Handbook on Best Practices in Agri/Rural Finance*, Agricultural Credit Department State Bank of Pakistan, p.6, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

Year	ZTBL	Commercial Banks	PPCBL	Private Banks	MFBs	Rs. Billion	%Change
2007-08	66.9	94.7	5.9	43.9	0.0	211.6	-
2008-09	75.1	110.7	5.6	41.6	0.0	233.0	10.1
2009-10	79.0	119.6	5.7	43.8	0.0	248.1	6.5
2010-11	65.4	140.3	7.2	50.2	0.0	263.0	6.0
2011-12	66.1	146.3	8.5	60.9	12.1	293.8	11.7
2011-12 P	37.8	107.6	6.0	37.3	8.5	197.4	-
2012-13P	38.0	123.7	5.4	51.0	13.0	231.0	17.0

Source: State Bank of Pakistan
P: Provisional (July -Mar)

Table3: Supply of agriculture credit by institutions

The Zarai Taraqiati Bank Limited on the other hand, has decreased for the last few years its share in the agriculture loan to a very great extent.[211] For example it has provided Rs.66.9, 75.1, 79.0 for the fiscal years 2008, 2009 and 2010 respectively. However, in 2010, 2011 the total amount for agriculture credit dropped down to Rs.65.4, 66.1 respectively. This is a very alarming situation as it is not expected from a specialized agricultural financing institution to reduce its share in the agricultural credit. While recognizing its fault, the bank has also introduced new schemes, particularly for local farming, which are very beneficial for lower class of farmer.[212] The details of all these schemes will be provided at the end of this chapter.

3.3.2 Easy Accessible for Local Farmers

Another benefit of informal agricultural finance is easy accessibility. The farmers mostly belong to the same area where the informal sources are available and therefore, face no barrier. The term “accessible” has two meanings in the present background. Firstly, it suggests that such informal sources are not far-flung from the residence of local farmers and therefore, they are not required to travel for a long distance. This saves time, energy and money which can be used in some other agriculture activities. Secondly, it signifies that the loan can be secured from such sources at any

[211]The table explains that besides ZTBL, the other financial institutions have made a very substantial change for the last few years in the total amount allocated for agriculture credit. It means that such financial institution has started taking interest to expend their financial operations and services to agriculture sector.

[212]These schemes include Kisan Dost Scheme, One Windo Operation Zarkhaiz Scheme, Asan Qarza Scheme, Sada Bahar Scheme, Awami Zari Scheme (both Farm and non Farm Credit), Crop Loan Insurance Scheme, Modle Village Establishment Scheme, Green Revolution scheme, Rural Development Scheme (specially designed for rural areas of the country), Agri Refinancing Scheme, etc ………………Details are available http://www.ztbl.com.pk/LoanSchemes.aspx (accessed: 13th May, 2014).

time, such as money lenders, friends, relatives, and commission agents can be contacted even at dusk or at early dawn. In Pakistan such accessibility is increasing due to some religious reasons. For instance, farmers and money lenders usually offer prayers five times a day in the mosque where they meet easily and discuss issues which are directly or indirectly related to farm credit. According to some researchers, some of the informal sources are more accessible as compared to others. For instance, friends and relatives are easily accessible sources as compared to money lenders and commission agents.[213] This tendency of farmers towards relatives and friends are owing to some undeniable facts. Firstly, money lenders and commission agents usually provide money at high interest rates while friends and relatives, on the other hand, provide the same facility mostly with zero interest rates. Secondly, money lenders and commission agents follow very strict procedure for the recovery of loan, and frequently such procedures can be humiliating. Relatives and friends, on the other hand, show flexibility to a great extent in this regard. They some time do not even fix a time for the repayment of loan and mostly recover their money or ask for the same after the lapse of a reasonable time.

3.3.3 Knowledge about Farmer's Economic Conditions

The most important aspect of informal finance is that the credit providers know the economic condition of a farmer who approaches them for the provision of loan facility. Therefore, they do not face any complication in order to know about the credit worthiness of a farmer; an essential character in order to reduce the risk of default. The reason is that the farmers and informal source providers are by and large living in the same village or at least in the same locality and hence, the collection of information regarding farmers' financial abilities becomes a time consuming activity. M. Irfan, G. M. Arif, Syed Mubashir Ali and Hina Nazliargue that, "the dominance of informal credit has been attributed to various factors. Because of geographic proximity of the lending sources, borrowers usually have low transaction costs if they resort to informal sources."[214] This peculiar characteristic of informal finance reduces the transactional cost to a

---

[213]Inayatullah Jan, Sania Munir, Abid Usman, Muhammad Idrees, *Agricultural Credit Markets in Northwest Pakistan:Implications for the Development Policy*, Sarhad J. Agric. vol.28, no.3, 2012.

[214]M. Irfan,G. M. Arif,Syed Mubashir Ali,Hina Nazli, *The Structure of Informal Credit Market in Pakistan,* Research Report No. 168, Pakistan Institute of Development Economics, http:// www.pide.org.pk/pdf/rr/RR168.pdf(accessed: 19th April , 2014).

great extent, as no expenditures are incurred over the collection of information. Some of the researchers have also proved the same characteristic of informal finance in their work.[215]

3.3.4 Low Transaction Cost

Transactional cost has a direct relation with the rate of interest i.e. if the transaction cost is high then the rate of interest goes up and vice versa. Therefore, any cut in transactional cost, consequently, reduces the rate of interest. Shahidur R. Khandker and Rashidur R. Faruqee have the same view by stating

> "Unlike formal loans, informal loans have small transaction costs, which reflect the opportunity cost of funding and are independent of collateral, duration, and size of loans. Informal lenders also perform an important role by facilitating the marketing of products or purchasing inputs, such as fertilizer".[216]

Both these scholars have also discussed those reasons which are responsible for such small transaction cost. For example, in their view, transactional cost in informal finance is usually free from collaterals, duration and size of advanced loan. The low transaction cost of informal credit has also been recognized by the State Bank of Pakistan.[217] Winfried Manig,[218] while discussing the importance of informal market for the development of rural areas, has highlighted that the transactional costs, including the lenders' and borrowers' direct transactional costs, are always lower in informal credit than that of formal credit.[219] He adds that transactional costs include the costs of information supply, enquiry, negotiation, agreement, control, risk and

---

[215]Fazal Wahid Zia Ur Rehman, *Share of the Informal Loans in Total Borrowing in Pakistan: A Case Study of District Peshawar*, Journal of Managerial Sciences, vol. VIII, p.103.

[216]Shahidur R. Khandker, Rashidur R. Faruqee, *The Impact Of Farm Credit In Pakistan* , World Bank,p.2,http://www-wds.worldbank.org/.../IB/.../130530322_20041117174105.pdf(accessed June 30, 2013)

[217]*Executive Summary*, State Bank of Pakistan http://, www.sbp.org.pk*/report/ExecutiveSummary.pdf* (accessed May 21st, 2014)

[218]Winfried Manig is a well renowned professor at the Institute of Rural Development, University of Gottingen, Germany.

[219]Winfried Manig, *The Importance of the Informal Financial Market for Rural Development Financing in Developing Countries: The Example of Pakistan*, The Pakistan Development Review 35: 3 (Autumn 1996), pp. 229-239.

insecurity assessment, guarantee, control and enforcement of agreements as well as the regulation of conflicts.[220] All these expenses or majority of them usually not applicable in informal credit and, therefore, the transaction costs drop to a very large extent. Such feature is missing in formal credit where too much extra expenses are made for all of the above mentioned headings. All these expenses are then recovered from the customer in the shape of returns. Nabeel Goheer highlights the inexpensive nature of informal finance (particularly in rural areas of Pakistan) by admitting the low transactional cost involved.[221] However, he observes that there are no standard terms and conditions for the determination of rate of interest and resultantly interest rates are different for different transactions. This observation of the learned authors is very ironical in nature as it defeats the whole theory that the low transactional costs pave a way for the low interest rates.

3.3.5 Mostly Free of Interest

Informal finance, as already mentioned, is generally provided by moneylenders, commission agents, relatives, friends, and neighbors. The money lenders and the commission agents charge high interest rates from their customers owing to the fact that they have started such business for the purpose of earning a profit. Some time the level of charging high interest rates goes beyond the limits and touches the boundaries of exploitation. Kadidia Konare has the same view by stating

> "The old consensus in the analytical literature on rural credit is one of the exploitative/evil informal moneylenders that charge overly high interest rates to borrowers and thus gain large monopoly profits".[222]

---

[220]Ibid, p.235.

[221]Nabeel Goheer, Micro Finance; *A Prescription for Poverty and Plight of Women in Rural Pakistan, Rural Finance For Growth and Poverty Alleviation*, http://, www.gdrc.org/icm/country/pak-microfinance.pdf(accessed May 21st, 2014).

[222] Kadidia Konare, *Challenges to Agricultural Financing in Mali*,A Plan B Paper Submitted to Michigan State University in partial fulfillment of the requirements for the degree of Master Of Science Department of Agricultural Economics 2001,http://fsg.afre.msu.edu/mali_pasidma/Konare_Challenges_Ag_Financing.pdf(accessed May 21st, 2014).

"In case the loan is taken from other informal sources such as relatives, friends and neighbors; terms and conditions to repay the loan are flexible with no interest rates. There are several reasons for this. Firstly, they have very close social relations with the debtors i.e. blood relations, neighborhood, friendship and hence do not ask for any interest from them. Secondly, they advance loan on the philosophy of reciprocity which means that they will provide loan facility to others at the time of need and the other will do the same when they are in need . This phenomenon is called technically 'Reciprocity Based Social Relations'. Adnan Qadir states

"Lending and borrowing among relatives, neighbors, friends and other socially close lenders are very common for financing needs, especially for consumption-smoothing purposes. Such transactions have the advantage of being collateral-free and, in most cases, free of interest as well. These transactions rely on the principle of reciprocity and represent informal social insurance schemes; both the lender and the borrower gain from the transaction and the process become self-sustaining".[223]

In the view of some rural expert finance, this free interest loans create problems for formal financial institutions, particularly those operating in the rural part of the country. The reason is interest based loans cease to be attractive when interest free loans are available. This may be one reason why traditional financial institutions in Pakistan find it difficult to take dynamic strategic decisions regarding opening branches in rural areas of the country. The State Bank of Pakistan acknowledges the problem. The following words, by the central bank issued for rural and agricultural finance, narrate the whole story

"Since the special costs and risks were involved in RF that made formal financial institutions reluctant to extend & expand credit facilities in rural

[223]Adnan Qadir ,*A Study of Informal Finance Markets In Pakistan*, with a study of SMEs by Dr. Faisal Bari and Adeel Faheemand a survey by the Punjab Economic Research Institute, Pakistan Microfinance Network ,December 2005,http://www.microfinanceconnect.info/assets/articles/informal.pdf(accessed: 13th April 2014).

areas, therefore, governments and donors were urged to intervene in rural financial markets".[224]

The State Bank of Pakistan does not disclose the real reason behind the interest-free nature of informal financial structures, particularly, when the credit is provided by friends and relatives, and instead, highlights minute factors. However, the literature reveals that zero percent interest rates has become a major problem for financial institutions. Even a well-developed country like China faces similar problems in rural parts of the country. Calum G. Turvey, Rong Kong, experts of rural finance, argue that,

> "The fifth problem is that informal borrowing amongst farmers' household friends and relatives in rural areas is incredibly, strong and culturally directed ………Furthermore, the interest charged amongst friends and relatives is for the vast majority zero percent. This could be problematic. The socially beneficial interest rate that could be charged by MFIs' is where the marginal benefits as a function of household income or wealth equal the marginal costs".[225]

The above statement clearly shows that informal finance is preferred by farmers because it is cheaper and culturally relevant as compared to formal finance. This is quite natural, since it is not possible for a farmer, who is not in a position to fulfill his basic agricultural requirements to pay high interest rates to a financial institution.

3.3.6 Easy Procedure

The easy procedure followed in informal finance is another rationale for its success in agriculture finance, particularly in rural parts of the country. The reason is that such financing facility is mostly provided by moneylenders, commission agents, friends, relatives and neighbors who are

---

[224] *Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department State Bank of Pakistan, p.6, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

[225]Calum G. Turvey,Rong Kong ,*InformalLending Amongst Friends and Relatives: Can Microcredit Compete in RuralChina?*,Paper Submission for CERMi First European Research Conference on Microfinance 2-4 June 2009 Brussels, Belgium Wednesday, March 25, 2009,p.4.

living in the same locality of borrowers (debtors). M. Irfan, G. M. Arif, Syed Mubashir Ali and Hina Nazli use the term "Geographical Proximity," to describe informal finance.[226] Fazal Wahid and Zia Ur Rehman suggest that the informal system of finance has a very simple and straight forward procedure with the following four simple steps.[227]

1. Informal request from the farmer directly or through his relative (asking the creditor to provide the required loan).
2. Time framework from the creditor for the advancement of loan (which usually consists of 2 -3 days).
3. Advancement of loan directly by the creditor or through his agent (who is normally a farmer from the same locality) to the farmer.
4. Repayment of the advanced loan at a time which is in most cases not mutually settled but understood.

These easy and simple terms make informal financing popular among the farming community. The State Bank of Pakistan, therefore, has advised the financial institutions to follow simple procedures while advancing loan to a farmer.[228] However, this advice is followed neither in letter nor spirit by conventional banks, and they continue to follow complicated procedures for advancing loan. Some of the scholars suggest that financial institutions can learn financing techniques from informal sectors, for instance, they can follow simple procedures, reduce many requirements, open branches that are accessible to towns and villages of farmers etc. Tatiana Nenova, Cecile Thioro Niang and Anjum Ahmad suggest that

---

[226]M. Irfan,G. M. Arif,Syed Mubashir Ali,Hina Nazli, *The Structure of Informal Credit Market in Pakistan*, Research Report No. 168, Pakistan Institute of Development Economics, http:// www.pide.org.pk/pdf/rr/RR168.pdf (accessed: 19th April, 2014).

[227]Fazal Wahid, Zia ur Rehman, *Share of the Informal Loans in Total Borrowing in Pakistan: A Case Study of District Peshawar*, Journal of Managerial Sciences, vol.VIII, no, p.103

[228]For example, the State Bank of Pakistan states in a guideline issued for financing agriculture, particularly that of rural area "There is increased accessibility to microfinance loans due to minimal documentary requirements and simplified lending procedures. Loan borrowers are exempted from submitting the usual documentary requirements for credit evaluation and approval, e.g., audited financial statements or statements of income and expense which borrowers find hard to comply. Loans are given even without collateral, and loan repayment is adjusted to the cash flow of the borrower to encourage timely payment. The incidence of borrowing from formal sources among small farmers has increased significantly mainly because of the increased accessibility of microfinance services in the rural areas"*Handbook on Best Practices in Agri/Rural Finance*, Agricultural Credit Department .State Bank of Pakistan, pp15-16 http:// www.sbp.org.pk, accessed December 25, 2012).

> "The formal sector could learn a lot from and partner with informal providers – their services are perceived as being more geographically accessible, less complex, with fewer requirements, and easier to understand".[229]

This statement points to the need for conventional financial institutions to revise their policies related to financing agriculture both in crop and non-crop activities. Such drastic changes, if adopted, may not only make agribusiness more viable for such commercial institutions but it may also prove to be very fruitful for farmers, especially those who reside in rural parts of the country.

3.3.7 Adjusting to Changing Circumstances

Agricultural financing poses challenges for policy makers of conventional banks and other financial institutions. This is because of the risks that are involved. These risks include droughts, floods, hail storms, earthquakes, mudslides and a multitude of other mishaps.[230] These risks vary with time and region; however, many risks are common in all agriculture sectors of various countries. Before financing agriculture and its sub sectors, the decision making authorities of financial institutions question the risks, demands, reliability, feasibility reports etc from experts. However, the informal finance providers do not require many questions as they are mostly residents of the same area and have knowledge of all natural risks. Therefore, they are flexible as far as the recovery is concerned at the time of natural disaster and natural mishaps. In addition, they cannot be cheated by habitual non-payer farmers who declare natural risks as a major cause for default of payments. This distinctive feature of informal finance increases the recovery rate and makes informal agribusiness more viable. While referring to the work of Adam and Ghate, a young researcher Jochem Zoetelief states that informal finance is flexible in adapting to changes, convenient, and has a high recovery loan and client friendly nature.[231] Ashok Gulati and Seema

---

[229]Tatiana Nenova, Cecile Thioro Niang and Anjum Ahmad, Bringing *Finance to Pakistan's Poor: A Study on Access to Finance for the Underserved and Small Enterprises*, 2009, World Bank International, http:// wwww.siteresources.worldbank.org/PAKISTANEXTN/.../BringingFinancePakistan.(accessed May 30th , 2014).

[230] Muhamoud A.Gulaid, *Financing Agriculture Through Islamic Modes And Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia: Islamic Research And Training Institute Islamic Development, Bank, 1995) Research No.34, p.50.

[231]Jochem Zoetelief, *Perspectives on Informal Rural Finance*,, Posted September 1999,Food and Agricultural Organization of the United Nation, http:// www.fao.org/sd/ppdirect/ppan0015.htm(accessed June 5th , 2014)

Bathla also have the same opinion regarding the informal financing in India.[232] Being very flexible in nature, majority of farmers prefers to get informal finance rather to go for formal finance as the previous is more suitable for the perilous nature of agriculture. While taking loan from the conventional financial institutions, the farmers always feel tense for the repayment of the same within the time prescribed in the loan transaction. This immense pressure psychologically disturbs his agricultural activities by one way or another which may lead to, in a very worst situation, to the decrease in production rate. The informal finance on the other hand, is mostly provided by the relatives or neighbors and friends who always ready to extend the repayment time at the time of difficulty. Adam B. Elheraika, a well renowned researcher, has also discussed the same flexible and adjustable feature of informal lending in his work.[233]

3.4 Demerits of Informal Sources of Agricultural Credit

Despite the many advantages of informal finance for the development of agriculture and its various sub sectors, there are also some disadvantages. These are explained below.

3.4.1 Charging Higher Interest Rates

A major critique on informal finance is that providers charge high interest rates on the principal amount of loan. Notwithstanding, contributing 70% of agricultural credit in Pakistan, they also charge the farmers with high mark up.[234] In countries like Sudan, money lenders follow the same agricultural financing practices.[235] Some scholars contend that money lenders in most developing countries charge exploitive interest rates.[236] This tendency for charging high interest rates creates

---

[232]Ashok Gulati ,Seema Bathla, *Institutional Credit to Indian Agriculture: Defaults and Policy optiotions*, Occasional Paper 23, National Bank for Agriculture, and Rural Development, Mumbai 2002, https://www.nabard.org/pdf/OC%2023.pdf(accessed June 5th , 2014).

[233]Adam B. Elheraika, *On the Experience of Islamic Agricultural Finance in Sudan: Challenges and Sustainability*,Islamic Research and Training Institute Islamic Development Bank, Jeddah, 2003, Research Paper No. 63, http:// www.irtipms.org/PubText/204.pdf(accessed 20th June, 2014).

[234]Ahmad Kaleem, *Outlook for Islamic financing of agriculture*, March 2007, http:// www.pakissan.com/.../outlook.for.islamic.financing.of.agriculture.shtml(accessed: 15thFebruary , 2014).

[235]Agricultural Finance Program, Department of Agricultural Economics, October 1989 And Rural Sociology The Ohio State University Annotated Bibliography On Agricultural Credit And Rural Savings: Xiii (Aspecial Issue On Informal Finance), p.3,http:// pdf.usaid.gov/pdf_docs/PNABJ788.pdf(accessed June 21st, 2014).

[236]Waiter Schaefer – Kehnert and Jhon D.Von Piodike, *Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.17.

more problems for the farmers rather than to solve the same. The State Bank of Pakistan has also strongly criticized this behavior of money lenders by stating

> "The fact that 70% of Agriculture Credit requirements not being met had resulted in Charging of extremely high (50% to 100%) interest rates by the informal agricultural credit providers from the needy farmers in every province of Pakistan".[237]

This statement is an alarming one as it indicates that informal finance providers charge (50% to 100%) interest rates, which is very high and almost imaginable for farmers, particularly those belong the lower class. It is a valid question, which may be put by a man of ordinary prudence , that how it is possible for a lower class of farmer, who is not in position to buy for himself the basic agricultural input and requirements, to pay such a high interest rate. It is rightly, then mentioned by Waiter Schaefer – Kehnert and Jhon D.Von's report that money lenders are charging enormous interest rates from farmers.[238] It is, therefore, duty of the state to go for a suitable legislation, make some rules and regulations for money lenders and monitor them strictly, so they may not misuse the compelling situation of farmers.

Further, money lenders in Pakistan do not charge interest rates according to specific criterion, such as, the amount financed and the length for the time of repayment, instead, payment plans are random. Adnan Qadir has the same observation by stating,

> "Informal markets are generally characterized by high interest rates and a sizeable gap between lending and deposit rates. There is extreme variability in the interest rate charged by lenders for similar loan transactions."[239]

The statement clearly shows the lack of specific methods for the measurement of interest rates. There is no particular scale for the determination of repayment schedule. These

---

[237]Executive Summary, State Bank of Pakistan, http:// www.sbp.org.pk/report/ExecutiveSummary.pdf (accessed June 5th, 2014).

[238]Waiter Schaefer – Kehnert and Jhon D.Von Piodike,*Agricultural Credit Policy in Developing Countries*, World Bank Reprint Series: Number 280, January.1982, p.17.

[239]Adnan Qadir ,*A Study of Informal Finance Markets In Pakistan*, with a study of SMEs by Dr. Faisal Bari and Adeel Faheemand a survey by the Punjab Economic Research Institute, Pakistan Microfinance Network ,December 2005,www.microfinanceconnect.info/assets/articles/informal.pdf(accessed: 13th April 2014).

problems can be easily solved through a positive and effective intervention of the state under the philosophy of 'Public or General Interest'. Laws pertaining to the violation of rules and regulations (by money lenders or any other provider of informal finance) can also be considered under the same philosophy. However, such rules should not be one sided i.e. only to focus and check activities of money lenders, but should also regulate activities of the farmers related to loan transaction (for example repayment of advanced loan within the given time).

3.4.2 Suitability for Pakistani Farmers

Pakistan is a majority Muslim country with a population of 174 million (the second largest Muslim population country after Indonesia).[240] According to the Islamic belief, Muslims are strictly prohibited by the Holy *Qur'ān* and *Sunnah* of the Holy Prophet (SAW) to secure any loan on interest basis. Besides the religious prohibition, the law of the country does not allow any interest based transaction in any form.[241] Taking an interest based loan is not a preferred choice for Muslim farmers in the country, therefore, informal sources of financing, particularly when the money is provided by a money lender on interest basis, is also not an appropriate choice for them. This places in doubt the claim by the State Bank of Pakistan and other sectors, claiming that 70% agricultural credit is provided by the informal sources. The only possible answer to this question is that friends, relatives and neighbors are also informal source providers; who usually lend money without interest. Dimitri Germidis states that in the case of Bangladesh, 63% of credit is provided by informal sources whereas 77% of such credit is given to farmers. He further adds that from 77% of agricultural credit 50% is provided by relatives and friends, 13% by the "well to do", and 13% by professional money lenders.[242] The case of Pakistan is not different where a major portion of informal financing is provided by relatives and friends.

---

[240]Muslim population: Indonesia, Pakistan, India, Bangladesh, Egypt, Countries with the biggest Muslim Populations, http:// en.reingex.com/Muslim-population-countries.asp (accessed June 21st, 2014).

[241]On 14th of Ramazan 1420, the Sharī'ahAppellate Bench of the Supreme Court of Pakistan gave a historical decision on the prohibition of interest in its all forms. This decision was given after fifty five years of the country's independence and had provided a guideline for all other Muslim countries to remove interest based activities from their economies. A well renowned scholar Mufti Muhammad Taqi Usmani played a vital role in this regard ………..http://www.albalagh.net/Islamic_economics/riba_judgement.shtml (accessed June 21st , 2014)

[242]Dimitri Germidis, *Savings and Development*.vol. 14, no. 1 (1990), pp. 5-22.

It is pertinent to mention that these free interest loans are not only based on religious principles but also on social norms. For example Calum G. Turvey and Rong Kong highlight the case of China and state" In modern day China, the evidence suggests, and quite overwhelmingly, that friends and relatives no longer charge interest on loan".[243] The statement explicitly shows that in China, where the religion (particularly Islam) has no concern in economic matters, the friends and relatives provide free interest loan purely on social considerations.

3.4.3 No Legal Documentation

A legal drawback in informal finance is that the loan transaction is not properly documented as required by the law of the land. This creates a serious problem for both parties when they have a dispute and differences over various terms of the transaction, such as, the amount borrowed, time of repayment etc. Another drawback of this system is that any of the aggrieved party cannot go to the court for the purpose of seeking a solution or compensation, based on the fact that informal finance's transactions are social in nature and cannot, therefore, be enforced through the court of law.[244] However, it does not mean that in case of a dispute there is no solution. The social values, norms and customs are sufficient for the enforcement of the contract. In this regard Adnan Qadir says that

> "Social sanction and market limitations are the most common instruments for the enforcement of contracts as well as the recovery of loans. Resorting to the legal system of the country is fairly uncommon. Moneylenders usually take various precautionary measures before taking on a new client. These include

---

[243]Calum G. Turvey,Rong Kong ,*Informal Lending Amongst Friends and Relatives: Can Microcredit Compete in RuralChina?*,Paper Submission for CERMi First European Research Conference on Microfinance 2-4 June 2009 Brussels, Belgium Wednesday, March 25, 2009,p.4.

[244] According to the Law of Contract, those promises are not enforceable in the court of law where the parties have no intention to create any legal obligation. Such intention is some time derived from the explicit words used by the agreed parties or it can also be inferred from the circumstantial evidences in which the agreement is signed. In short, the main difference between the social and legal agreements is the intention of the parties to create any legal obligation or not. If they do not want to create any legal obligation then their relation is deemed as a social one and technically called social agreements. Such agreements do not give rise to any legal consequences whereby it means that none of the party can knock door of the court in case of breach. ………. For further details please visit The Law Handbook, http://www.lawhandbook.org.au/handbook/ch12s01s02.php(accessed June 21st , 2014).

> the practice of dealing with the potential client in other markets, extensive scrutiny of new clients and through small "testing loans"."[245]

The statement clearly indicates that such transactions are enforced through effective social forces. The social pressure runs the contractual relations smoothly and in case of dispute, a mediator is selected by both the parties for the resolution of the matter. The main reason for non-documentation of loan transaction in informal finance is that both parties are familiar with each other and, therefore, do not feel the need for documentation. However, the social pressure is not enough for the solution of dispute, particularly when the disagreement is of serious nature. It is, therefore, need of the time and responsibility of the state at the same time to bring some technical changes in the structure of informal finance and regulate all the involved issues with proper legal process. Some of the developed countries like Philippine has felt this stressing need and their researchers have suggested some changes in the existing structure of informal finance. The work of Sogrorio L. Floro is very remarkable in this connection, where he has recommended numerous alterations in the existing informal finance structure in Philippine.[246]

3.4.4 Not Sufficient in Nature

There is a major defect in the informal finance that the amount advanced to a farmer is not sufficient to fulfill his basic agricultural requirement both for crop and non-crop activities, such as, seeds, fertilizers, herbicides, weedicides, herbicides, insecticides, sprays, basic agricultural machinery, etc. The reason is that informal finance is mostly provided by neighbors, friends, relatives and money lenders,[247] who do not have huge funds for allocation to agriculture and its various sub-sectors. They lend small amount to farmers at the beginning of a season. The money lenders on the other hand, provide comparatively a larger amount, but that too very small and not

[245] Adnan Qadir ,*A Study of Informal Finance Markets In Pakistan*, with a study of SMEs by Dr. Faisal Bari and Adeel Faheemand a survey by the Punjab Economic Research Institute, Pakistan Microfinance Network ,December 2005,www.microfinanceconnect.info/assets/articles/informal.pdf(accessed: 13th April 2014).
[246] Sogrorio L. Floro, *Technical Change and the Structure of Informal Credit Markets In Philippine Agriculture*, Journa/ of Philippine Development Number Twenty-Five, vol XIV, no. 2, 1987, http://serp-p.pids.gov.ph/serp-p/download.php?d=487(accessed June 23rd , 2014).
[247] Dimitri Germidis,*Savings and Development*.vol. 14, no. 1 (1990), pp. 5-22.

enough to fulfill farmers' requirements. The reason is that money-lenders, who run their personal business, having a small amount of capital. Inayatullah Jan, Sania Munir, Abid Usman and Muhammad Idreeshave the same view by stating,

> "The poor easily access the informal credit markets such as friends, relatives, neighbors, commission agents or professional moneylenders. These lenders advance small amounts for short periods…………..”[248]

This statement clearly indicates that the advanced loan is not only small but is given for a very short time period, for example, one harvesting cycle. It is quite possible that a farmer may not be in a position to repay the amount because of natural calamities, such as, droughts, floods, hail storms, earthquakes and mudslides.[249] The informal loan providers, particularly money lenders, do not provide any relaxation to the effected farmers.

In the past, the informal finance was sufficient to fulfill the basic agricultural requirements of a farmer. But with the passage of time the agricultural expenditures have increased rapidly due to various factors like expensive seeds, new types of artificial fertilizers and new agricultural machinery. Owing to this fact, the demand for agricultural credit has increased in comparison to the demands in the past. Even in a developed country like China, the informal finance is insufficient for farmers' agricultural requirements both for crop and non-crop activities. Sai Tang, Zhengfei Guan and Songqing Jin comprehensibly discuss the issue in their exhaustive research. They state

> "With the rapid economic growth, informal credit supply may not be sufficient to meet the increased demand for relatively larger amount of credit as farmers start to engage in more diversified or more capital intensive economic activities (e.g. high valued crops and non-farm business activities)”.[250]

---

[248]Inayatullah Jan, Sania Munir, Abid Usman, Muhammad Idrees, *Agricultural Credit Markets in Northwest Pakistan:Implications for the Development Policy*, Sarhad J. Agric. vol.28, no.3, 2012.

[249] Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia: Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34, p.50.

[250]Sai Tang, Zhengfei Guan, Songqing Jin,*Formal and Informal Credit Markets and Rural Credit Demand in China*,http://ageconsearch.umn.edu/.../Formal%20and%20Informal%20Credit%20Ma.(accessed June 24th, 2014).

5.4.3 Overdependence on Trust

It is a common practice that credit is always backed by various security measures so that a creditor may surely receive his principal amount along with the interest, where the repayment is not given within the given time. The security involved includes both movable and immovable properties. The former is called a pledge while the latter is known as a mortgage. The security shows the credit worthiness of a borrower and plays an important role in the smooth dealing between a creditor and a debtor. However, in informal finance the creditor does not demand any security from the farmer. Manfred Zeller, an expert of rural finance confirms the same fact while saying

> "…….Borrowing from socially close lenders within the moral economy is often the first recourse that poor households have in financing expenses, especially those related to essential consumption expenditures. Transactions are collateral-free and in most cases interest is not charged. These are essentially informal mutual aid schemes that have the principle of reciprocity at the core of transactions"[251]

The trust and confidence which the credit provider has over the debtor eliminates the need for security for the loan. This approach poses difficulties only when a farmer is not in position to repay the amount or is unwilling to repay. Due to lack of collaterals and other securities, the creditor faces a very critical situation as he can neither get back his amount nor can he go to court to file a suit. This causes an uncomfortable situation as the creditor and debtor are more often than not socially connected with each other, and the dispute may lead the situation to an extent where such relation may be damaged. The creditor can turn, in such circumstances, to his friends and other social members for the resolution of the dispute. This mechanism is

---

[251]Manfred Zeller, *Models of Rural Finance Institutions*, Invited lead paper for the International Conference on Best Practices in Rural Finance June 2-4, 2003 in Washington, D.C., institute of Rural Development Waldweg 26 37073 Göttingen, Germany, http://www.gwdg.de/~uare(accessed June 21st, 2014).

the most successful one and, therefore, many of the scholars who are familiar with informal financing techniques, recommends the same solution by stating

> "Social sanction and market limitations are the most common instruments for enforcement of contracts as well as the recovery of loans. Resorting to the legal system of the country is fairly uncommon. Moneylenders usually take various precautionary measures before taking on a new client. These include the practice of dealing with the potential client in other markets, extensive scrutiny of new clients and through small "testing loans"."[252]

This statement clearly indicates that social forces play a vital role in the solution of such disputes. It also suggests that small testing credit worthiness techniques should be used by a creditor before advancing a loan facility.

3.5 Formal Agricultural Finance in Pakistan

Formal agricultural finance is the kind of finance which is provided by formal institutions like conventional banks, specialized financial institutions, financial co-operatives and credit unions. Majority of these financial institutions are formed for profit earning purposes and, hence, they run their business under the philosophy of "profit Maximization". Their income is usually based on interest which they charge on the advanced loan, and provision of variety of services like keeping accounts for depositors, ATM Cards and Laser Card services, safe locker deposits, transfer of money for customers, receiving money on the behalf of customers, and issuance of Letter of Guarantees etc. However, advancement of interest based loan always plays a major role in achieving the goal of maximization of profit.

In Pakistan there are two kinds of formal financial institutions. The first kind includes those financial institutions which work purely on the basis of interest while the second category consists of those financial institutions which are working according to the principles of Islamic commercial law, and has their own rules and regulations. The latter category's financial institutions strictly prohibits interest in any form, uncertainty, cheating and deception, and

---

[252]Adnan Qadir ,*A Study of Informal Finance Markets In Pakistan*, with a study of SMEs by Dr. Faisal Bari and Adeel Faheemand a survey by the Punjab Economic Research Institute, Pakistan Microfinance Network ,December 2005,www.microfinanceconnect.info/assets/articles/informal.pdf(accessed: 13th April 2014).

gambling. Having two entirely different systems in terms of philosophies, rules and regulations; both conventional and Islamic banking are ineffective for the development of middle and lower sectors of society, majority of which belong to the agricultural sector.

The history of formal agricultural finance in Pakistan could not be developed fully as the country gained independence in recently times i.e. 1947. However, the special financing policies developed by the British were continued by the government of Pakistan after independence. Therefore, the history of agricultural credit can be traced prior to independence. Muhammad Iqbal, Munir Ahmad and Kalbe Abbas has the same opinion by stating

> "The history of institutional credit in Pakistan starts from pre- independence meager amount of taccavi loans and loans from co-operative societies that were working at that time. The farmers were heavily dependant on non-institutional sources for their credit requirements."[254]

However, the statement clearly shows that such institutional credit facilities were not enough to fulfill the basic requirements of agricultural sector both for crop and non-crop activities and, therefore, the informal sector played a vital role in the development of agriculture and its various sub sectors.

The British government, while recognizing the importance of agriculture sector in the subcontinent, had introduced some special legislation in order to enhance agricultural activities in the region. For instance, in the beginning the Land Improvement Loans Act of 1883 (LILA) and Agricultural Loan Act 1884 (ALA) were introduced and later both these Acts were replaced by the West Pakistan Agriculturists Loan Act of 1958 (ALA) in order to regulate Taccavi loans.[255] The British government had focused more on the urban areas while ignoring rural parts of the subcontinent. This was huge oversight, as the rural areas were a major hub for agricultural activities. Maqbool Hussain Sial, Masood

---

[253]Muhammad Tahir Mansoori, *Islamic Law of Contracts and Business Transactions*, (Islamabad: Sharī'ahAcademy International Islamic University, 3rd Edition, 2006.

[254]Muhammad Iqbal, Munir Ahmad, Kalbe Abbas and Khalid Mustafa, *The Impact of Institutional Credit on Agricultural Production in Pakistan,* The Pakistan Development Review, vol. 42, no. 4, Papers and Proceedings PART II Nineteenth Annual General Meeting and Conference of the Pakistan Society of Development Economists Islamabad, January 13-15, 2004 (Winter 2003), pp. 469-485, Pakistan Institute of Development Economics, Islamabad, http://www.jstor.org/stable/41260420. (accessed: July 4,2013.

[255] Ibid,p.470.

Sarwar Awan and Muhammad Waqas, while referring to the past research of some known scholars, describe that besides Taccavi loans, some cooperative societies and cooperative banks were other sources of institutional credit at the time.[256]

The central bank of Pakistan opened a separate agricultural credit department for the development of the agricultural sector. According to Section 8 (3) of the State Bank Act, "the bank shall create a Special Agricultural Department …". [257] The central bank also hired experts to study issues related to agricultural credit and advise the Federal Government, Provincial Government, Provincial Cooperative Banks and Banking Organization. However, prior to 1972 such efforts were limited to the state, and the conventional banks' loans for the agricultural sector were insignificant.[258]

In Pakistan, the formation of Agricultural Bank and Agricultural Development Finance Corporations (ADFC) in 1950's could be considered the first major step for the Development of agriculture sectors. The purpose behind both these financial institutions was to overcome the credit shortage prevailing at that time. Later on in the 1960's both institutions were merged and a specialized agricultural bank was formed i.e. the Agricultural Development Bank of Pakistan (ADBP).[259] This bank later named Zarai Tariqiati Bank Limited (ZTBL)[260]. It was a leading conventional financial institution working for the development of the agricultural sector both in crop and non-crop activities through the provision of financial services. Its job was also to provide technical

---

[256]Maqbool Hussain Sial, Masood Sarwar Awan, Muhammad Waqas, *Role of Institutional Credit on Agricultural Production*,A Time Series Analysis of Pakistan, International Journal of Economics and Finance, vol. 3, no. 2; May 2011.

[257]The State Bank of Pakistan Act 1956, Chapter iii (Management) ,Section 8 (3) , http://www.sbp.org.pk/about/sbpact/SBP_ACT_1956.pdf(accessed March 3, 2013).

[258]Sara Saeed Khan, *Rural Finance Policy in Pakistan its Scope, Sources and Implications for the Microfinance Sector*, Pakistan Microfinance Network 2009,p.4 www.microfinanceconnect.inf,http://(accessed March 3, 2013)

[259]Saima Ayaz, Sof ia Anwar, Maqbool Hussain Sial, Zakir Hussain, *Role of Agricultural Credit on Production Efficiency of Farming Sector in Pakistan- A Data Envelopment Analysis*, Pakistan Journal of Life and SocialSciences, Pak. j. life soc. Sci. (2011), 9(1): 38-44.

[260]Zarai Taraqiati Bank Limited (ZTBL) formerly known as Agricultural Development Bank of Pakistan (ADBP) is a leading conventional financial institution, working for the development of agriculture sector both in crop and non crop activities throug the provision of financial services. It also provides technical assistance to the agricultural sector by various ways .The critical purpose of the institution is to augment the agriculture and rural sector by lifting up farm production, reforming the institutional credit and increasing income generating capacity of the farming community. ZTBL was incorporated as a Public Limited Company on 14th December, 2002 through repeal of ADB Ordinance of 1961. http:// www.ztbl.com.pk/ (accessed April 3, 2013).

assistance to the agricultural sector by various ways. The critical purpose of the institution was to augment the agriculture and rural sector by lifting up farm production, reforming the institutional credit and increasing income generating capacity of the farming community. ZTBL was incorporated as a Public Limited Company on 14th December, 2002 through repeal of ADB Ordinance of 1961.[261] However, the bank did not play the role which was intended at the time of its inception.

The state Bank of Pakistan had recognized the fact that ZTBL could not cover the agricultural sector's requirements efficiently. It issued various mandatory regulatory frameworks, compelling the commercial financial institutions to allocate certain portions of their credit portfolio for the development of the agriculture sector. The following statement, can be cited as an example of such mandatory rules,

> "In order to increase the rural branch net-work, SBP has made it mandatory for banks to open at least 20% rural branches while opening their new ones."[262]

The government of Pakistan initiated the Banking Reforms in 1972 which brought considerable changes in commercial bank policies, concerning the equitable distribution of credit. In addition, the Agricultural Loan Scheme was also introduced that required all commercial banks to finance agriculture.[263] The commercial banks while following instructions of the central bank had started financing agriculture both for crop and non-crop activities. These banks included existing commercial banks of the country, such as, Allied Bank Limited (ABL), Habib Bank Limited (HBL), United Bank limited (UBL), National Bank Limited (NBP), Muslim Commercial Bank (MCB), etc. However, it was observed by the Agricultural Advisory Committee, that a major portion of agricultural credit had been used by farmers for non-agricultural purposes. The committee also showed their concerns regarding the recovery of such loans. These situations compelled the Pakistan Banking Council (PBC) to call upon agricultural credit experts and other stake holders to develop a comprehensive guideline for extending

---

[261]The above details are take from the official website Zarai Tariqiati Bank Limited (ZTBL)……………. http://www.ztbl.com.pk/(accessed April 3, 2013).

[262]*Handbook on Best Practices in Agri/Rural Finance*, Agricultural Credit Department State Bank of Pakistan, p.7, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).
[263]Ibid,p.5.

agricultural credit. According to the scheme, commercial banks were restricted to disburse agricultural credit only in their respective regions. However, in 2001 this restriction was opposed by the commercial banks, and its withdrawal was demanded. The Muslim Commercial Bank Ltd (MCB) played a leading role in this connection. In August 2001, fourteen new Domestic Private Banks were inducted under section 5 of Banking Companies Ordinance 1962.

The above commercial banks, however failed badly to fulfill the required objectives demanded by the State Bank of Pakistan (SBP).[264] There were many reasons for the failure of these financial institutions; however, the following had a major role,

- Agricultural sector had some potential risks including both natural calamities (like droughts, floods, hail storms, earthquakes, mudslides and a multitude of other mishaps)[265] and artificial catastrophes, like, price risks both for inputs and crops, political risks, risks related to poor support infrastructure), [266] and Investment in such a sector would mean facing potential risks which was not a desirable option.
- These commercial banks were asked by the State Bank of Pakistan to advance loans to the agricultural sector and its various sub-sectors without demanding collaterals from farmers. In some cases they were asked to provide loan facility by requiring only personal sureties.[267]

While summarizing, it may be stated that in Pakistan there were too main sources of agricultural credit i.e. institutional sources and non-institutional sources. The previous included the ADBP (now ZTBL), commercial banks, co-operative and domestic private banks while the latter

---

[264] Maqbool Hussain Sial, Masood Sarwar Awan, Muhammad Waqas, Role of *Institutional Credit on Agricultural Production:A Time Series Analysis of Pakistan*, International Journal of Economics and Finance, vol. 3, no. 2; May 2011, P.127.

[265] Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50.

[266] Lamon Rutten,*Innovative Agricultural Finance and Risk Management Strengthening Food Production and Trade in the Transition Region*, Working Paper, Prepared under the FAO(Food and Agriculture Organization of the United Nations) /EBRD(European Bank for Reconstruction and Development Cooperation),p.28, http://www.fao.org/.../WP7-Innovative_agricultural_finance_and_risk_managem.(accessedJuly 24, 2013).

[267] *Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department State Bank of Pakistan, p.7, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

included friends, relatives, neighbors, and professional money lenders. Among all these sources a major portion of the agricultural credit was provided by the ZTBL, followed by the commercial and cooperative banks. The following table illustrates the statement

.

Supply of agricultural credit by institutions (Rs. In million)						
Year	ZTBL	Commercial	Cooperatives	Domestic	Total Amounts	% Change
Banks				Private Bank		
1998-99	30176.00	7236.00	5440.00	-	42852.0	28.3
1999-00	24423.90	9312.50	5951.2	-	39687.6	-7.4
2000-01	27610.00	12055.00	5124.2	-	44789.2	12.8
2001-02	29108.00	17486.10	5273.7	578.5	52446.3	17.1
2002-03	29270.20	22738.6	5485.4	1424.5	58918.7	12.3
2003-04	29933.07	33247.45	7563.54	2701.80	73445.86	24.6
2004-05	37408.84	51309.78	7607.82	12406.82	108732.91	48.0
2005-06	47594.14	67967.40	5889.49	16023.38	137474.40	26.4
2006-07	56473.05	80393.18	7988.06	23976.16	168830.45	22.8
2007-08	66938.99	94749.29	5931.45	43940.92	211560.66	25.3
2008-09	45399.87	74364.60	3538.89	28557.24	151860.60	9.6
Source: - Govt. of Pakistan 2003-04, 2007-08, 2008-09.						

Table 4: Supply of agriculture credit by institutions

3.5.1 Defects in Formal Agricultural Financing in Pakistan

In Pakistan, the informal sources were mostly used by farmers of rural areas in the country instead of formal sources. There were many reasons for this. Some of these reasons had pointed out by the Committee on Rural Finance,[269] constituted by the State Bank of Pakistan in order to look after the issues involved in rural finance and suggest

---

268 Naushad Khan, Malik Muhammad Shafʿī , Musawar Shah,Ziaul Islam, Mohammad Arif, Rukhsana Javed, Naeem Shah, *Review of Past Literature on Agriculture Credit In Rural Area of Pakistan*, Sarhad J. Agric. vol.27, no.1, 2011,p.104.

269 The committee on Rural Finance was constituted by the Governor of the State Bank of Pakistan. The main task of the committee was to know about the basic problems faced by the rural finance of the country and to present solid solution for the same. The committee had fulfilled the given task in a very systematic and scientific manner as it studied the rural credit from all possible angles. For example, the committee went into minute details of supply and demand of rural credit, followed by detailed interviews of various segments of the society particularly those which are directly or indirectly involved in the rural credit programs. Some of the experts from financial institutions are also resorted in order to get valuable suggestions for the solution of the problem………………………(Report of the Committee on Rural Finance, State Bank of Pakistan,http://www.sbp.org.pk/report/contents.htm(accessed May 28th , 2014).

improvement in the existing structure of financing. The learned members of the committee highlighted the following flaws in rural finance.[270]

3.5.1.1 Unjust Distribution of Agricultural Credit

The financial institutions of the country (like the specialized bank for financing agriculture i.e. Agricultural Development Bank, commercial banks and Cooperative Banks) did not distribute the credit on the basis of justice. The upper class of farmers (landlords) were provided a major portion of agricultural credit while the middle and lower class of farmers, that deserved more to be financially assisted, had deprived. The subsidized agricultural credit was also provided to the upper class of farmers for being more politically influential and financially stable to provide the collaterals, required by these financial institutions for the provision of loan facility.[271]

3.5.1.2 Lack of Experienced Staff

The staff of Agriculture Development Bank, Commercial Banks and Cooperative Banks had no agricultural academic back ground and had no experience as far as the agricultural sector was concerned. This led to a situation where such institutions badly failed to mobilize deposits and made loan portfolio of good quality. For example, such financial institutions were not in a position to make the recovery rate better, minimize the transactional costs, and reduce the political influence in disbursing loans. Many financial institutions became bankrupt and stopped their financial activities in rural areas of the country.

---

[270]Report of the Committee on Rural Finance, State Bank of Pakistan,http://www.sbp.org.pk/report/contents.htm(accessed May 28th , 2014).

[271]It is a matter of fact that majority of farmers belong to lower class of the society and hence they are not more often than not in position to provide the mandatory collaterals demanded by the financial institutions. Such requirements are deliberately conditioned by such financial institutions as they are very much disinclined to finance and help out poor sectors of the society. Therefore, it is noticed that majority of financial institutions be fond of to finance like stock, poultry farming, horticulture, dairy farming , fish farming etc as all these sectors are usually owned by upper class that afford the huge investments required by these sectors. The local farming, which is mostly a profession of lower class of farmers, is entirely unnoticed instead of its importance for the economic stability of the country.In the view of some experts such approach of the financial institutions.

3.5.1.3 More Concentration on Urban Areas

The financial institutions had concentrated more on urban areas as compared to rural areas of the country. There were many reasons for this tendency. Firstly, the Pakistani agriculture was predominantly rural in nature.[272] It means that majority of agricultural activities, particularly those related to local farming, had to be carried out in rural areas. The remoteness of rural areas compelled the financial institutions to give less priority to the expansion of their business in such areas. Secondly, the rural areas of the country had greatly suffered from political instability and therefore opening branches in such areas was like a commercial suicide.[273] Thirdly, a major chunk of the population was living in rural areas, majority of whom belonged to the lower class,[274] and therefore, were not the preferred customers for financial institutions.

3.5.1.4 No Step for the Minimization of Agricultural Inherited Risks

The financial institutions that were actively involved in financing agriculture in rural areas did not take necessary steps in order to minimize the inherited risk of agricultural financing.[275] The insurance facility, which was normally available in urban agricultural credit, had not extended to rural agriculture finance. The lack of proper measures for risk minimization turned the agriculture less viable for conventional financial institutions.

---

[272]Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, vol. 38, no. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716.

[273]There are many rural areas in the country which face badly political instability. These areas include Swat, Bajuar, Waziristan, Orakzai , Mohmand etc . Some of these areas like are federally administered while others are under the control of provincial government. The military of Pakistan carried out various operations in such areas for the purpose to maintain the law and order situation. Some of these operations have proved very successful while in some areas the instability still exists.

[274]Abdul Waheed Bhutto ,Aqeel Ahmed Bazmi, *Sustainable Agriculture and Eradication of Rural Poverty in Pakistan*, Natural Resources Forum 31 (2007) 253–262, www.ciitlahore.edu.pk/Papers/173 8589019295997357795.pdf(accessed: 20th March, 2014).

[275]Agriculture sector is always prone to many natural risks i.e. droughts, floods, hail storms, earthquakes, mudslides and a multitude of other mishaps. Before embarking on investment in various agricultural activities, the commercial banks and other financial institutions ponder over these risks from many aspects………Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability,* (Jeddah Saudi Arabia: Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50.

3.5.1.5 Lack of Knowledge Regarding Agricultural Requirements

The employees of financial institutions had no awareness regarding various agricultural activities both in crop and non-crop sectors and consequently had no idea about various agricultural requirements. This problem was noticed by the State Bank of Pakistan and therefore, issued guidelines on various financing schemes particularly those which were related to agricultural financing in order to create awareness among the banks' officers regarding agriculture finance.[276] In addition to this, some instructions were also communicated to the main branches of various financial institutions, asking them to circulate the same in their rural branches. Such instructions were mainly focused on objectives of the central bank, which it expected from the issuance of such guidelines (and these objectives were obviously related to the development of the agriculture sectors particularly that of rural areas). Moreover, the central bank had published brochures about various loan schemes and translated the same into Urdu and many local languages. Some training programs were also organized in collaboration with various commercial banks, aimed to create awareness among the farmers regarding various loan schemes and to increase the capacity of commercial banks in agricultural and rural finance through the training of their corresponding agricultural credit officers.

3.5.1.6 High Interest Rate on Agricultural Credit

The commercial banks in rural areas had charged high interest rates from the farmers and exploited their compelling situation (as they were in need of money in the beginning of a season to fulfill their basic agricultural requirements) to a great extent. Being a major contributor in the county's food requirements, it was supposed that financial institutions would provide loan to rural farmers on the easiest terms and conditions. However, these financial institutions had showed a completely different approach and provided loan at high interest rates to the agriculture sector both in crop and non-crop activities. The driving force behind this approach was the philosophy of profit

---

[276] *Frequently Asked Questions (FAQs) On Agri Financing*,Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/ACD_FAQs.pdf(accessed: 28th February , 2014).

maximization and safeguarding shareholders' interests (owners of financial institutions). For instance, the rate of interest was between 10 to 20 percent and surprisingly it was 17 percent in Barani Punjab, followed by 17 percent in Baluchistan.[277] According to researchers, the State Bank of Pakistan was itself responsible for such exploitative rates of interest as it had given a free license to all financial institutions to charge any rate of interest. The statement given in the guideline issued for financing small farmers could be presented as solid evidence" Bank shall determine mark-up on the basis of KIBOR and their cost of funds in line with their credit policy. Banks shall not charge any penalty on early repayment / adjustment of loan."[278] After this free license, one could hardly expect the financial institutions to charge low interest rates from the lower class of farmers. However, the issue was not only limited to Pakistan and there were many other financial institutions in various parts of the world that charged high interest rates**.** Adeleke Salami, Damilola Felix Arawomo describes the issue of high interest rates in Africa with minute detail.[279] The authors contended that the financial institutions should reduce the rate of lending which would guarantee access to the agricultural credit by farmers.

3.5.1.7 Demand for High Collaterals

Another major defect in formal finance was the demand of high collaterals for the advancement of loan. This prerequisite acted as a main hurdle for farmers to secure loans from commercial banks and other financial institutions. They were not in a position to furnish such securities, and consequently left their intention to get the loan facility. This approach was intentionally done, keeping away the lower class of farmers from securing financial facility. As a result, only the middle and upper class of farmers

---

[277]Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab*, European Journal of Scientific Research ISSN 1450-216X Vol.23 No.2 (2008), pp.294-304 http://www.eurojournals.com/ejsr.htm(accessed January,2013).

[278]*Financing Scheme for Small Farmers*, Agricultural Credit Department, State Bank Of Pakistan, http://www.sbp.org.pk/acd/FinancingSchemeSmallFarmers.pdf (accessed January,2013).

[279]Adeleke Salami, Damilola Felix Arawomo, - *Empirical Analysis of Agricultural Credit in Africa: Any Role for Institutional Factors*,Working Paper 192, www.afdb.org/.../working-paper-192-empirical-analysis-of-agricultural-. (accessed: 2nd May , 2014).

received a sizable portion in agricultural loan as they were in good position to furnish such securities. Some of the scholars noticed the same issue and rightly stated,

> "In Pakistan 88% of the total farming population has less than five hectare of land. They are living from hand to mouth. Moreover, majority of these farmers do not have collateral and thus are deprived of the loan facilities".[280]

Muhammad Khalid Bashir and Muhammad Masood Azeem proved through an empirical research that majority of farmers had demanded that collaterals should be either waived off or it should be reduced to a minimum level.[281]

Due to the reasons mentioned above, majority of farmers had a natural tendency toward the informal sources and consequently opted it for the fulfillment of their various agricultural requirements both in crop and non crop activities. A study conducted by Shahidur R. Khandker and Rashidur R. Faruqee clearly indicated that only 10.9 million rupees was contributed by formal sources to agriculture credit while the informal sources went ahead and contributed 38.85 million rupees for the same purpose.[282] The following table could be presented for further details.

---

[280] Urooba Pervaiz, Dawood Jan, Muhammad Zafarullah Khan, Mahmood Iqbal,Rukhsana Javed, *Disbursement of Agricultural Loans, Constraints and its Future Policy Implication*, Sarhad J. Agric.vol.27, no.2.

[281] Muhammad Khalid Bashir and Muhammad Masood Azeem, Agricultural Credit in Pakistan : Constraints andOptions, Pak. j. life soc. sci. (2008), 6(1): 47-49, www.pjlss.edu.pk/sites/default/files/47-49.pdf(accessed: 2nd May, 2014).

[282] Shahidur R. Khandker and Rashidur R. Faruqee,*The Impact of Farm Credit in Pakistan*, World Bank, http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2653(accessed May 10th , 2014).

Formal sources	Percentage	Informal sources	Percentage
Government	4.8	Friend/relative	57.2
ADBP	86.5	Commercial agent	4.9
Commercial Bank	3.2	*Arthi*	6.0
Cooperative	1.8	Input supplier	5.9
NGO	3.7	Shopkeeper	7.0
		Landlord	12.8
		Employer	1.9
		BISI and others	4.3
Total amount of formal loans (million rupees)	10.90	Total amount of informal loans (million rupees)	38.85

Table 5: Distribution of loan by sources

Source: Shahidur R. Khandker and Rashidur R. Faruqee, The Impact of Farm Credit in Pakistan, World Bank, http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2653 (accessed May 10th, 2014)

3.6 Conclusion

In Pakistan agriculture sector is financed by two main sources i.e. formal and informal. Both types of sources are very much viable for financing agriculture and its development. The informal sources are existing from unknown times, having their own merits and demerits. For example, the informal credit providers have sufficient knowledge about basic agriculture requirements of the local farming, and therefore, provide adequate funds to the local farmers for the fulfillment of such requirements. Similarly, informal agricultural finance is very much accessible in nature which means that money lenders, friends, relatives, and commission agents can be contacted even at dusk or at early dawn for the provision of loan. In addition, credit providers know about credit worthiness of a farmer who approaches them for the provision of loan facility. The transactional cost in informal finance is very low, owing to the fact that such type of financing usually free from information supply, enquiry, negotiation, agreement, control, risk and insecurity assessment, guarantee, control and enforcement of agreements as well as the regulation of conflicts. This characteristic keeps the rate of interest to a very low and acceptable level. Being provided mostly by relatives, friends and neighbors; terms and conditions to repay the loan are flexible with no interest rates. Instead of all these merits, the informal sources also accommodate some demerits. For instance, some of the informal loan providers in Pakistan like

moneylenders and commission agent provide interest based loan which is strictly prohibited by the Holy *Qur'ān* and *Sunnah* of the Holy Prophet (SAW). Similarly, the parties do not go for the documentation of loan transaction as required by the law of the land. This leads to a very difficult situation where the concerned parties have differences over various terms of the transaction, such as, the amount borrowed, time of repayment etc. Moreover, due to the lack of collaterals and other securities, the creditor faces a very critical situation in case of borrower's default. All these shortcomings can be surmounted through the introduction of formal sources of agriculture finance like conventional banks, specialized financial institutions, financial co-operatives and credit unions. Such sources are existing in the country (Pakistan) since its independence and playing their role in the development of agriculture sector, both in crop and non crop activities. However, study reveals that such sources did not achieve the intended objectives because of so many reasons. Firstly, the financial institutions of the country prefer the upper class of farmers in terms of financing and ignore the lower class of farmers who deserve more to be financially assisted. The subsidized agricultural credit is provided to the upper class of farmers for being more politically influential and financially stable to provide the collaterals, required by these financial institutions for the provision of loan facility. Secondly, the financial institutions usually has no experience in financing agriculture, and therefore, face failure to mobilize deposits and made loan portfolio of good quality. They are still not in a position to make the recovery rate better, minimize the transactional costs, and reduce the political influence in disbursing loans. In addition, the employees of such financial institutions have no awareness regarding various agricultural activities both in crop and non-crop sectors and consequently have no idea about various agricultural requirements. Although this problem has solved by the State Bank of Pakistan through the issuance of various guidelines and brochures related to financing agriculture. The high interest rates also reduce the viability of formal sources for financing agriculture. For example the rate of interest is usually between 10 to 20 percent which is very much high. The State Bank of Pakistan itself responsible for such exploitative rates of interest as it has given a free license to all financial institutions to charge any rate of interest. On the same way, the financial institutions demand high collaterals for the advancement of loan. This prerequisite act as a main hurdle for farmers, particularly those related to local farming, to secure loan facility from financial institutions

CHAPTER 4

LEGAL AND ECONOMIC ANALYSIS OF FORMALAGRICULTURE FINANCING IN PAKISTAN

4.1 Economic and Legal Analysis of Formal Agriculture Finance

This chapter deals with the legal regime of formal agricultural financing in Pakistan. It also critically analyzes the impact of this system on the economic health of farmers. The chapter also critically analyzes laws, rules and regulations issued by the State Bank of Pakistan that govern agricultural financing i.e. the laws related to the procedure in agriculture finance, the legal requirements for the disbursement of agriculture loan, the nature of required collaterals, rules and regulations for the supervision of farmers' use of agricultural credit, laws for the recovery of loans, criteria and bench mark for the determination of interest rates etc. The economic perspective of formal financing agriculture, on the other hand, means broadly the socio-economic impact of agricultural credit on farmers' life. The chapter will also discuss the impact of agricultural credit on farmers' living standard, increase in the rate of production per hectare; their savings in comparison to their past, etc has to be discussed in details. Moreover, the impact of agricultural loan on agriculture development will also be studied with minute details.

4.2 Legal Analysis of Formal Financing in Pakistan

The following lines, the legal issues in the existing agricultural financing system will be discussed with minute details.

4.2.1 Rigid and Complex procedure

The basic philosophy of any legal system is to facilitate the people and not irritate them. This facilitation includes the easiest possible procedure in every aspect of human life. The philosophy of facilitation also obliges all institutions, which are related to the human life by one way or another, to facility the people in terms of their rules, regulations and make their procedure very much easier to the last extent. Islamic law encourages the same philosophy in its entire legal framework. However, this bright principle of all legal system has not been followed by the financial institutions particularly when they finance agriculture and its various sectors.

The financial institutions in Pakistan follow a specific procedure for the advancement of loan facility. Such procedure is usually very rigid, comprises of many steps, and takes excessive time for its completion. In case of agricultural loans, procedures become more rigid because of the inherited risks involved in this sector. Before getting a loan, a farmer is required to give meticulous information of his movable (for example tractor, farm implements, car, motor cycle, cattle, other animals etc.) and immovable property (for example agricultural land, house etc.), income details/ source of income, the loans secured in the past from financial institutions, and his existing loans, the status of such loans, detailed description of the purposes for which such loans were acquired, his repayment behavior of the past loans, name of the concerned banks, nature of securities deposited with these banks, outstanding liability of the past loan if any, size of the area that he cultivates and the size that he does not, size of the land that he owns, nature of such land (irrigated or non irrigated ,rainy or arid), Khatooni and Khasra number, his educational qualification, etc.[283] Due to this elongated, exhausting procedure, a farmer who applies for a short term loan, in the beginning of a season, to buy basic agricultural inputs like fertilizers, herbicides, Insecticides, weedicides, pesticides etc., if lucky, gets it by the end. Study shows that agricultural credit usually requires 1-3 months for its sanction and imbursement.[284] In Sudan, a developed agricultural country, the farmers face the same situation owing to the very slow cumbersome lending procedure followed by Agricultural Bank of Sudan (ABS).[285] Similar is the case of Indian farmers where experts of the field observe that the financial institutions do not provide adequate credit to the agricultural sector. Some of the main reasons for such inadequacy are the cumbersome procedures, formalities to transact credit, untimely delivery of credit, inequality in the distribution of credit etc.[286] Such unrequited procedure, resultantly augments

---

[283]*Financing Scheme for Small Farmers*, Agricultural Credit Department, State Bank of Pakistan, pp9-10 ,http:// www.sbp.org.pk (accessed January,2013).

[284]Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab*, European Journal of Scientific Research ISSN 1450-216X, vol.23 no.2 (2008), pp.294-304.

[285]Badawi B. Osman,*The Experience of the Sudanese Islamic Bank in Partnership (Musharakah) Financing as a Tool for Rural Development among Small Farmers in Sudan*, Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 221-230.

[286] Devaraja T.S, *An Analysis of Institutional Financing and Agricultural Credit Policy in India* (The work described in this working paper was substantially supported by a grant from the University Grants Commission of India), May 2011,pp.14-15.

the administrative cost and hence the financial institutions demands high interest on agricultural loan. This usually happens in small loans which are mostly provided to lower class of farmers for local farming. Walter Schaefer-Kehnert and John D. Von Pischke conclude the same by stating, "The smaller the loan, the higher the interest rate required covering the lenders' costs".[287] While realizing the same fact, the State Bank of Pakistan recommends conventional and Islamic banks to simplify their lending procedure. In a handbook issued for rural agricultural finance, the central bank discusses its financing policy by stating,

> "There is increased accessibility to microfinance loans due to minimal documentary requirements and simplified lending procedures. Loan borrowers are exempted from submitting the usual documentary requirements for credit evaluation and approval, e.g., audited financial statements or statements of income and expense which borrowers find hard to comply. Loans are given even without collateral, and loan repayment is adjusted to the cash flow of the borrower to encourage timely payment. The incidence of borrowing from formal sources among small farmers has increased significantly mainly because of the increased accessibility of microfinance services in rural areas".[288]

However, many of the conventional as well as Islamic financial institutions in Pakistan do not follow such instructions and maintain the sturdy procedure for the advancement of agricultural credit, both for crop and non crop activities. For example the Zarai Taraqiati Bank Ltd. (ZTBL) still demands high collaterals and charges high interest rate from the farmers.[289] In Sudan and India, the banks deal farmers in the same way.[290] Some of the researchers believe that majority of

---

[287] Walter Schaefer – Kehnert and Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280, 1982.p.4.

[288]*Handbook on Best Practices in Agri/Rural Finance* ,Agricultural Credit Department, State Bank of Pakistan,pp15-16 http:// www.sbp.org.pk,accessed December 25, 2012).

[289]See details regarding collaterals at the official website of Zarai Taraqaiti Bank Limited (Pakistan). ,http://www.ztbl.com.pk/ (accessed July 12, 2011).

[290]Badawi B. Osman,*The Experience of the Sudanese Islamic Bank in Partnership (Musharakah) Financing as a Tool for Rural Development among Small Farmers in Sudan*, Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 221-230;Devaraja T.S, *An Analysis of Institutional Financing and Agricultural Credit Policy in India* (The work described in this working paper was substantially supported by a grant from the University Grants Commission of India), May 2011,pp.14-15.

farmers in Pakistan, particularly those who are landless and belong to the lower class of farmers, find it very difficult to avail institutional credit due to complex procedure.[291]

But the question comes to the mind of a vigilant reader that how such multifarious procedure can be simplified in order to encourage the farmers to opt agricultural credit for the development of their agricultural activities? While solving the same problem, interest of all stake holders should be adhered so none of the concerned parties may suffer. In other words, the vested interest of farmers as well as that of commercial banks and other financial institutions should be watched over. Some of the experts scholars of the field suggest the 'the group lending' strategy.[292] In their view, this strategy can be used as a best tool to avoid the complex procedure on one hand and the issue of high collaterals on the other.

4.2.2 Demand of High Collaterals and other Securities

As already mentioned that a vast majority of farmers belong to the lower class of society and, therefore, are in no position financially to fulfill some of their basic agricultural needs. They either resort to money lenders or financial institutions for financial assistance. The former provide loan facility without any demand for collaterals and securities owing to their close relations with farmers.[293] Due to this reason, this source has been mostly used by farmers to accomplish their agricultural requirements. The case of financial institutions is entirely different as they do not provide a single penny without fitting collaterals and other securities. These securities are normally of higher value than loans advanced, since they cannot otherwise serve the intended objectives i.e. protection of loan.

---

[291]Naushad Khan, Malik Muhammad Shaf'ī , Musawar Shah,Ziaul Islam, Mohammad Arif, Rukhsana Javed, Naeem Shah, *Review of Past Literature on Agriculture Credit In Rural Area of Pakistan*, Sarhad J. Agric. Vol.27, No.1, 2011,p.104.

[292]*Strengthening Agricultural Support Services for Small Farmers*, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

[293]In 1972 (only 11 percent of the credit amounts borrowed by rural households was provided by formal credit organizations, mainly by the commercial banks and the ADBP. More than 89 percent of the credit was borrowed from informal sources; the principal lenders were friends and relatives who provided almost 58 percent of the credit amounts, followed by tradesmen who supplied 16 percent. If the number of loans is taken as a basis, only 7 percent came from formal Sources"…………………… Winfried Manig, The *Importance of the Informal Financial Market for Rural Development Financing in Developing Countries: The Example of Pakistan*, The Pakistan Development Review35 : 3 (Autumn 1996) pp. 229—239.

These collaterals are of a wide variety i.e. real estate, automobiles, cash accounts, investments, insurance policies, valuables and collectables, future payments, gold, ornaments etc. Most of the financial institutions prefer primary collaterals (liquid assets) over secondary collaterals (illiquid assets) as the liquidation value of an asset decreases as the asset becomes more illiquid.[294] However, in case of agriculture sector, the immovable property is favored by the financial institutions. In some countries' financial institutions, the required value of such collaterals is very high and hence beyond the reach of farmers. Majority of these farmers possess the lands as tenants and hence not legally authorized to mortgage such lands and very few of them have their own land[295]. The report of Agricultural Census 2000 shows that only 37 percent farmers of the rural areas have their own land while 61 percent of these land-owning households owned fewer than five acres, or 15 percent of total land.[296] Owing to the risks inherited by the agricultural sector, some farmers even in the developed countries like America, have failed to repay the agricultural loan and consequently lost their business and lands.[297] Due to this reason majority of the farmers stay away from getting agricultural loan and prefer to get it from informal sources even at a higher interest rate. They do not want to lose their small piece of land which is in most cases a source of life for them. As an upshot, the financial institutions also do not provide loan facility to the agricultural sector both for crop and non crop activities.

In Pakistan, the problem of collaterals and other securities is being realized at state level and hence various measures have been taken for the solution of the same. For instance, a guideline issued by the State Bank of Pakistan explicitly recommends group based lending for

---

[294]Johan F. M. Swinnen, Hamish R. Gow, *Agricultural Credit Problems and Policies During the Transition to a Market Economy in Central and Eastern Europe*, Food Policy 24 (1999),pp 21–47 www.ruralfinance.org/.../1217526012269_agricultural_credit_problems_in_ECA_region.pdf -(accessed March,2013).

[295]Improving Agricultural Microfinance Barriers to the supply of agricultural lending in the Philippines, Final Draft April, 2009,(This study was undertaken by the Innovations for Poverty Action (IPA) with support from the Hanns Seidel Foundation/Germany (HSF) which is financed by the Federal Ministry of Economic Cooperation and Development (BMZ) under the joint project: "Microfinance Capacity Building Program," in partnership with the Ninoy and Cory Aquino Foundation (NCAF), formerly the Benigno S. Aquino, Jr. Foundation (BSAF), and the PinoyME Foundation (PMF)). http:// www.poverty-action.org (accessed January,2013).

[296]Mazhar Arif, *Agriculture And Food Security In Pakistan*, Thematic Paper,p.13.

[297]Naira Grigoryan, *Agricultural Lending System & Contracts in the Republic of Armenia*(Master Paper), American University of Armenia, 2007, Yerevan, Republic of Armenia, http:// law.aua.am/files/2012/02/Agricultural-Lending.pdf - Cached-(accessed March,2013).

financing agriculture without any collateral and other forms of securities. The following statement can be presented as concrete evidence in this regard,

> "(The State Bank of Pakistan has) Issued Financing Scheme for Small Farmers on group based lending methodology whereby members of the group can borrow up to Rs 200,000/- without any collateral from financial institutions"[298]

The group based lending is an optimum solution for all stake holders of agricultural finance i.e. financial institutions and farmers in the sense that the former gets satisfaction for the recovery of his advanced loan (as all the group members are collectively responsible for the repayment of loan and will never allow any one of them to default) while the latter secure the money without any collaterals. In addition, the amount of Rs. 200,000/- is very quite sufficient for the fulfillment of basic agricultural requirements particularly in the beginning of a season. However, another guideline issued by the State Bank of Pakistan limits this unsecured amount to the extent of Rs. 500,000/-, i.e."A borrower can avail a maximum unsecured financing up to 5 lacs from all banks/DFIs as per Prudential Regulations for Agriculture Financing".[299] So, both statements are differing in nature and may misguide the Islamic banks, Islamic financial institution and conventional financial institutions, to form a policy of their own, for financing agriculture and its sub sectors. However, a recent guideline issued by the State Bank (in January 2014) has fixed the amount to the extent of 1 million by stating,

> "Banks/DFIs shall not provide unsecured/clean financing facility in any form of a sum exceeding Rs 1.0 million (Rupees one million only) to any one person. Financing facilities granted without securities including those granted

---

[298]*Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

[299]*Frequently Asked Questions (FAQs) on Agri Financing,* Agricultural Credit Department State Bank of Pakistan, 2007, http:// www.sbp.org.pk/acd/ACD_FAQs.pdf. (accessed: 26th March, 2014).

against personal guarantees shall be deemed as "clean" for the purpose of this regulation."300

This regulation doubles the previous amount (which was 500,000/-) and clearly identifies the level of interest of the government for the development of agriculture sector. This amount is not only enough for lower class of farmers to fulfill their agricultural requirements but can also accomplish middle class farmers' needs to a great extent. This will pave the way for the growth of other sectors of agriculture like livestock, fish farming, horticulture, dairy farming, poultry farming; based on the fact that majority of middle class farmers are directly or indirectly dependant on these sectors.

Besides above, the financial institutions are also allowed to provide a loan facility to the extent of Rs.500, 000/- against two trusts worthy sureties in addition to passbook of the land.[301] This regulation will further bring ease for farmers to secure loan as they can easily provide two voluntaries from their friends, relatives etc.

Like Pakistan, some other countries of the same region take some concrete measures for enhancing the cap of collateral free agricultural credit. For instance, in India the financial institutions have been asked by the central bank to increase the level collateral free loans from RS. 50,000/- to Rs.1, 00,000/-. In a similar way the cap of General Agricultural Credit Card Scheme has been increased from Rs.25, 000/- to Rs.50, 000. [302]

The issue of collaterals and other securities in agricultural credit do not exist only in Pakistan. The same hurdle is faced by farmers of various countries of the same region. These countries include the kingdom of Thailand, Bangladesh, Sri Lanka etc.

---

[300]*Prudential Regulations for Agriculture Financing,* Agricultural Credit & Microfinance Department State Bank of Pakistan, Updated on 29thJanuary, 2014, Regulation no.4, p.8 http://www.sbp.org.pk/publications/prudential/PRsAgriApproved.pdf, (accessed: 28th October , 2014).

[301]Further details are available at … *Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department State Bank of Pakistan, p.1, http:// www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014); Frequently Asked Questions (FAQs) on Agri Financing Agricultural Credit Department State Bank of Pakistan, 2007, http:// www.sbp.org.pk/acd/ACD_FAQs.pdf. (accessed: 26th March, 2014).

[302]*Flow of Credit to Agriculture Sector, With Special Reference to Tenant Farmers, Oral Lessees and Agricultural Labourers,* IBA Sub-Committee on Flow of Credit to Agriculture, Indian Banks' Association, http:// www.iba.org.in/events/flowofcreditcover.pdf(accessed: 26th March, 2014).

The kingdom of Thailand among these countries, have taken some concrete measure for the solution of the problem.

The Kingdom is also very keen for smooth growth of agriculture and its various sub sectors, evident from the fact that the Bank for Agriculture and Agriculture Cooperatives Thailand (BAAC)[303] provides loan facility to farm household without any substantial requirement of collaterals.[304] However, it ensures the repayment of loan through the joint liability group loans where each and every farmer is responsible for the repayment of loan individually and collectively. In view of Randolph Barker, Claudia Ringler, Nguyen Minh Tien, and Mark Rosegrant the same policy has been adopted in Vietnam and the farmers are allowed to receive 10 million VND for their agriculture requirement without any collateral. However, for commercial farms such limit has been increased to 20 million VND through a court order issued in 2002.[305] This shows the level of commitment by the Vietnam's government in the development of agriculture sector for all types of farming, either commercial or non commercial.

In Sri Lanka, the financial institutions do not provide loan facility without suitable collaterals. In view of Sharmini De Alwis and B. M. R. Basnayake,[306] these institutions always

---

[303]Bank for Agriculture and Agriculture Cooperatives Thailand was established by the Government of Thailand in 1966 under the jurisdiction of Ministry of Finance. The main purpose from its establishment was to help out farmers through the provision of various financial services. However, its concentration was mainly focused on the development of agriculture sector in rural parts of the country. The role of the bank could be easily understood from the fact that nearly 95%of total farm households in Thailand had covered by it………….. See for further details the official website of Bank for Agriculture and Agricultural Cooperatives (BAAC) , http:// www.baac.or.th/baac_en/1 (accessed: 26th March, 2014).

[304]Lolita Y.Poliquit ,*Accessibility of Rural Credit among Small Farmers in Philippine* ,2006, Massey University Palmerston, Newzeland, http:// mro.massey.ac.nz/bitstream/handle/10179/1687/02_whole.pdf?...1 (accessed: 26th March, 2014).

[305]Randolph Barker, Claudia Ringler, Nguyen Minh Tien, Mark Rosegrant, *Macro Policies and Investment Priorities forIrrigated Agriculture in Vietnam,* Comprehensive Assessment Research Report 6, Comprehensive Assessment Secretariat, ISBN 92-9090-583-2,http://www.iwmi.cgiar.org/assessment/files_new/publications/.../CARR6.pdf(accessed: 29th March, 2014).

[306]Sharmini De Alwis and B. M. R. Basnayake are serving as Deputy Director, Regional Development, and Senior Assistant Director, Regional Development, Central Bank of Sri Lanka respectively. Due to the active role of Central Bank, both of these authors have a lot of experience in agriculture finance and its various institutional, technical and strategic dimensions. Their practical experience, therefore can be used effectively for the development of agriculture sectors in other parts of the world particularly that of Central Asia.

use collaterals as a screening device.[307] They add that by pledging collaterals the borrowers show the financial institutions the viability of their project and strong willingness to pay the amount due. In their view, the SMEs always lack sufficient collaterals and hence not in a position to get their share from the formal credit market. Some other researchers like Harsha de Silva, Montek S. Ahluwalia are of the same view.[308] This situation badly affects the growth of agricultural sector and hence may cause a shortage of food. The government, therefore, has to take some solid measure to overcome the collateral issue, and should emphasize more on the growth of local farming in rural parts of the country. The Bangladeshi farmers are facing the same problems for the last two decades and hence are the most deprived in terms of financial assistance. Mohammad H. Mondal,[309] an expert of agricultural issues, has the same opinion.[310] While referring to the statistics issued by Bangladesh Bureau of Statistics (BBS), he says that only 27 percent farmers are able to secure loan from financial institutions. Another study reveals that 85 percent of farmers are securing loan from informal sources like relatives, friends, money lenders, etc due to the lack of collaterals.[311] These studies show that no suitable agricultural supportive environment has been created for Bangladeshi farmers and hence it also requires a serious attention from the concerned government. The international community has felt farmers' problems and hence some of the foreign banks provide loan facility to them without any

---

[307]Sharmini De Alwis, B. M. R. Basnayake,*Credit Guarantee Schemes in Sri Lanka --Way Forward*,第13期, pp. 51-82 , http://www.smeg.org.tw/doc/JSD-14-3.pdf(accessed: 29th March, 2014).

[308]Harsha de Silva, *An Innovative Fruit and Vegetable Market in formation System in Sri Lanka*: The Govi Gnana (Farmer Knowledge) Service, Presented at the USAID and World Bank sponsored Workshop: Inaugurating New Partnerships in the Global Food Chain at the 15th Annual World Food and Agribusiness Forum, Symposium and Case Conference, Chicago, USA. http://globalfoodchainpartnerships.org/cairo/papers/HarshadeSilvaSriLanka.pdf(accessed: 29th March, 2014);Montek S. Ahluwalia ,*Policies for Poverty Alleviation*, Asian Development Review ,Studies of Asian and Pacific Economic Issues; vol. 8 no. 1; 1990.

[309]Mohammad H. Mondal has a lot of experience in various aspects of agriculture due to his practical involvement. He has remained a Director General of Bangladesh Agricultural Research Institute (BARI) for a long time and therefore his writing on various agricultural related problems reflect his experience, and his suggestions are very much practicable in nature.

[310]Mohammad H. Mondal, *Crop Agriculture of Bangladesh: Challenges and Opportunities*, Bangladesh J. Agril. Res. 35(2), pp.235-245, June 2010.

[311]Firoja Akter Khanam, Kamrul Hasan, *Evaluation of Management of Agricultural Credit – A Case Study on Bangladesh Krishi Bank*, Journal of Education and Practice www.iiste.org ISSN 2222-1735 Paper) ISSN 2222-288X (Online) vol.4, no.13, 2013.

collateral. For instance the Grameen Bank which has been established since 1976 in Bangladesh, is one of the premier banks that strive for the poor sectors of the society through the advancement of loan without any asset requirement. While following its basic objectives, it has disbursed (in 2001) free collateral loan to 2.38 million borrowers; majority of whom belong to rural areas of the country.[312] In addition, the bank also reschedules the repayment at the occurrence of natural mishaps like flood, storm, earth quake, mudslide etc. For example, in 1998 the institution rescheduled the loans as half of its borrowers lost their agricultural yields. However, a single bank or few banks cannot cope with the situation in a populous country like Bangladesh and, therefore, an active role is required from the government to take concrete steps in this regard.

4.2.3 Lack of Proper Legal Mechanism for the Recovery of Agricultural Loan:

The main issue always faced by the financial institution in financing agriculture is the recovery of advanced loan from the farmers. Therefore, they are always reluctant to finance agriculture or any of its sub sectors. In case of intentional default on the side of a farmer, there is no proper legal system and mechanism to protect effectively the commercial banks and other financial institutions. The general procedure of law for the recovery of loan if followed, the amount on litigation sometime crosses the amount due. The State Bank of Pakistan demands the financial institutions to provide a specific portion of their credit to agricultural sector without any requirement of collaterals and securities by stating

> "(The State Bank of Pakistan has) Issued Financing Scheme for Small Farmers on group based lending methodology whereby members of the group can borrow up to Rs 200,000/- without any collateral from financial institutions".[313]

---

[312]Hishamunda, N.; Manning, P, *Promotion of sustainable commercial aquaculture in sub-Saharan Africa, Tackling the Issues of Collateral and High Interest Rates,* chapter.4 vol.2: Investment and economic feasibility.FAO Fisheries Technical Paper. No. 408/2. Rome, FAO. 2002, p. 54.

[313]*Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department, State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

In another guideline it states "A borrower can avail a maximum unsecured financing up to 5 lacs from all banks/DFIs as per Prudential Regulations for Agriculture Financing".[314]

However, the State Bank does not provide any of legal protection to such financial institutions in case when a farmer intentionally defaults. The law of compensation and damages that has been provided by the Contract Act of 1872[315] is the only possible way to deal with the situation. Sections 64,65,66,67,68,69,70,71,72,73,74 and 75 are the concerned sections of the Contract Act of 1872 which deal with remedies for the breach of a contract. According to these sections, the aggrieved party files a suit for the recession of the contract and followed by the suit for damages. The court then awards various remedies keeping in view nature of the case. If the parties have agreed upon liquidates damages at the inception of the contract, then the court may award the same amount of damages. However, the procedure followed by the courts under the Code of Civil Procedure 1908, is very slow in nature and usually the litigations take more time than the required. The other law which can be effectively used for the recovery of loan, advances and credit is the Banking Companies Act, 1997. However, this legal document too does not precede the recovery cases on immediate basis. Owing to the absence of proper legal mechanism, the recovery rate of agricultural loan is very low. Rao Abdul Rauf Khan, a well renowned researcher in the field of agricultural finance, has done an exhaustive work on the issue of farms loan recovery problem in Pakistan.[316] While

---

[314] *Frequently Asked Questions (FAQs) on Agri Financin,g* Agricultural Credit Department, State Bank of Pakistan, 2007, http:// www.sbp.org.pk/acd/ACD_FAQs.pdf. (accessed: 26th March, 2014).

[315] The Contract Act of 1872 is the main body of law which governs and regulates the legal contracts in Pakistan. Being derived from the English Law of the Great Britain, the decisions of the Britain's courts are also cited in the court of law for the solution of various contractual problems. Being too much old in terms of its basic philosophies, terms, theories, rules and regulations, this Act is not in a position to solve the day to day problems of the present markets. There is a tense need to amend the existing law according to the need of the time. In addition, this law should also be looked in from the perspective of Islamic law.

[316] Rao Abdul Rauf Khan ,*Farms Loans Recovery Problems in Pakistan: its Possible Solution*, The Pakistan Development Review, 33:4 Part 2 (Winter 1994),pp 837-843, http://pide.org.pk/pdr/index.php/pdr/article/view/1313/1286(accessed July 15th , 2014).

discussing the same issue, he considers that loan recovery rate is very low in Pakistan. He has collected data related to the recovery ratio of agricultural loan in various years by specialized agricultural financial institutions (Zarai Taraqiati Bank Ltd. (ZTBL) and Federal Bank for Cooperatives) and draws the following table.

Overdues and Recovery Situation During 8TH Plan Period

(Rupees in Million)

Institution/ Year	Demand	Collection	Balance	% Overdues to Demand	Overall Recovery (%)
Agri. Dev. Bank of Pakistan					
1988-89	8174.667	5211.467	2963.200	36.2	63.8
1989-90	10786.849	6579.672	4207.177	39.0	61.0
1990-91	13169.064	7808.523	5360.541	40.7	59.3
1991-92	17233.483	9438.104	7795.379	45.2	54.8
1992-93	14465.131	9019.159	5445.972	37.6	62.4
Total	**63829.194**	**38056.925**	**25772.269**	**40.4**	**59.4**
Federal Bank for Cooperatives					
1988-89	3060.500	2846.530	213.970	7.0	93.0
1989-90	2789.170	683.790	2105.380	75.5	24.5
1990-91	3950.200	2573.340	1376.860	34.9	65.1
1991-92	4194.980	2589.440	1605.540	38.3	61.7
1992-93	3276.450	2965.810	310.640	9.5	90.5
Total	**17271.300**	**11658.910**	**5612.390**	**32.5**	**67.5**

Source : Statistics Department, ADBP, Islamabad.
(US$ = Rs 31).

Table 6: Overdues and recovery situation during 8th plan period

The State Bank of Pakistan, being a central bank, does not play its required role in this regard and has left the issue to the discretion of the banks to determine and prepare

their own procedure mechanism for the recovery of loan. The following statement can be cited as evidence.

> "Banks/DFIs are also encouraged to prepare comprehensive recovery procedures, which should interalia specify certain triggers for taking specified actions while requiring reasons to be recorded in writing in exceptional cases where specified actions are not being taken."[317]

Here the statement clearly indicates that the state Bank has avoided its own duty and authorizes the financial institutions to prepare their own procedure for the recovery of agricultural loan. This blinded authorization may create problems from so many aspects. For instance, it is quite possible (after the delegation of such power from the central bank) that banks and other financial institutions may exploit such power and set up such rules and regulations which are against the natural justice or not serve interest of the farmers. Secondly, this authorization may result disuniformity in the recovery of agriculture credit and its procedure. Thirdly and more importantly, some situations which are necessary to be considered in agricultural loan and its repayment may not be well thought out in the determination of rules for the recovery of advanced loan. The natural calamities (like earth quake, mudslide, flood, natural diseases, untimely rainfall etc) for instance are beyond the control of a farmer, and hence such uncontrollable factors may cause default.[318] The financial institutions may make such rules based on which the repayment can be demanded even under these circumstances. The state of affairs may become ironical at a point where the policy of a commercial bank is against the following prudential regulation (R-5) of the State Bank of Pakistan

> "The banks/DFIs are allowed to grant relaxation up to one year in repayment schedule, to their borrowers who have been adversely affected due to certain

---

[317] *Prudential Regulations for Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan,p.6, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

[318] Rao Abdul Rauf Khan, *Farms Loans Recovery Problems in Pakistan: its Possible Solution*, The Pakistan Development Review, 33:4 Part 2 (Winter 1994), pp 837-843.

> unforeseen and unexpected factors like weather, availability of water, etc. which are not under the control of the farmers. Such relaxation may be granted on case-to-case basis or en-block to the borrowers in the affected area. Further, to prevent loan classification due to natural calamities, banks are encouraged to immediately stop recovery, suspend/defer mark-up accruals, and may issue instructions for waiving off outstanding markup or principal where the chances of recovery are not possible due to heavy natural calamities like earthquake, floods, heavy rains, epidemic diseases, etc."[319]

There is a clash, in fact, between R-1 and R-5 of the prudential regulations issued by the State Bank of Pakistan for financing agriculture.[320] For instance, R-1 authorizes all commercial banks and financial institutions to formulate any policy for repayment of advanced loans. The R-5 on the other hand, ask the financial institutions to show relaxation when the default is due to some natural mishaps like earth quake, floods, heavy rains, epidemic diseases, etc. The clash between two clauses may create a very serious problem at the time when a commercial bank does not accommodate the same relaxation in their recovery procedure. However, it is also quite possible that a farmer may misuse the relaxation and may intentionally does not repay the

---

[319] *Prudential Regulations for Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan,p.6, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

[320] The R-1 of the Prudential Regulations of Agricultural finance states "The banks/DFIs are allowed to grant relaxation up to one year in repayment schedule, to their borrowers who have been adversely affected due to certain unforeseen and unexpected factors like weather, availability of water, etc. which are not under the control of the farmers. Such relaxation may be granted on case-to-case basis or en-block to the borrowers in the affected area. Further, to prevent loan classification due to natural calamities, banks are encouraged to immediately stop recovery, suspend/defer mark-up accruals, and may issue instructions for waiving off outstanding markup or principal where the chances of recovery are not possible due to heavy natural calamities like earthquake, floods, heavy rains, epidemic diseases, etc." The R-2 of the same prudential regulation states"Banks/DFIs are also encouraged to prepare comprehensive recovery procedures, which should interalia specify certain triggers for taking specified actions while requiring reasons to be recorded in writing in exceptional cases where specified actions are not being taken. *Prudential Regulations for Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan,p.6, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

amount due presuming falsely that he has suffered from natural disaster and hence not in position to repay. Therefore, there is a need of balance approach so none of the stake holders to agricultural finance may suffer. The creation of this balance is the duty of the State Bank of Pakistan where it can impose penalties on those commercial financial institutions that do not provide relaxation to a farmer at the time of any natural disaster. On the other hand, it has to impose penalties on those farmers who do not repay the amount due intentionally. Both these clauses should be included in the prudential regulations set up for financing agriculture.

The recovery of advanced loan is not only beneficial for the banks and other financial institutions but it is equally advantageous for farmers as the main purpose of the bank from lending is to recycle the funds borrowed from the public or raised from the external or internal sources for the benefit of the society.[321] A major portion of such society in Pakistan comprises of farmers who are related to agricultural by one way or another. It is therefore a tense need of the time to make such laws which can effectively increase the recovery rate. The state Bank of Pakistan can play a vital role in this regard by two ways. Firstly, it can enhance the recovery ratio through the insertion of some new rules and regulations in the existing guideline for financing agriculture. These rules and regulations should be related to the following points.

- Asking the farmers strictly not to use the agricultural loan for any other purpose other than production.[322] In case of any violation, the concerned farmer may be deprived from any further financial aid.

- Credit officer should be obliged by the State Bank of Pakistan to supervise the advanced loan by himself or through authorized agent at various stages of harvesting cycle. In case of any violation, penalty should be imposed on the concerned bank.

---

[321] Rao Abdul Rauf Khan ,*Farms Loans Recovery Problems in Pakistan: its Possible Solution*, The Pakistan Development Review, 33:4 Part 2 (Winter 1994),pp 837-843, http://pide.org.pk/pdr/index.php/pdr/article/view/1313/1286(accessed July 15th , 2014).

[322] It is noticed that agricultural loan is vary rarely used for the purchase of basic agricultural input like seeds, fertilizers, herbicides, weedicides, insecticides etc and most of the time it is used utterly for traditional purposes like children school fee, electricity bills, marriage ceremonies etc rather than agriculture purposes.

- While advancing agricultural loan, the credit officer should be obliged to investigate the credit worthiness of the borrower through a variety of methods. For instance, his past credit history should be checked including a sharp glance to the fact that whether his previous repayments installments have paid on regular basis or not.

- The installments of agricultural loan should vary from person to person, region to region and nature of the loan. A uniform installment policy should be avoided under any stretch of explanation. For instance, in case of rural areas, a hub for the majority of farmers,[323] the installments should be small in terms of amount while should be lengthy in terms of duration. Similarly, the lower class of farmer should be facilitated more in repayment schedules as compared to that of urban areas as the latter have more opportunities for the development of his agribusiness. In the same way, the farmers of those areas which are suffered from natural mishaps should be given relaxation and their dues should be rescheduled.

Secondly, the State Bank of Pakistan can ask the parliament to legislate special laws for agricultural finance. Such legislation must comprise some rules and regulations which are directly or indirectly related to the repayment of advanced loan. For instance, in case of default the commercial institutions should be protected to follow complicated cumbersome and time consuming legal process for the recovery of their loan. Special agricultural courts, if easy and possible, can be established for the purpose to speed up the legal procedure. Similarly, the humiliating methods used by the financial institutions for the recovery of loan can also be banned through this legislation. By guarantying the self-respect of a farmer, may positively decrease the default ratio to a great extent.

---

[323]Abdul Waheed Bhutto ,Aqeel Ahmed Bazmi, *Sustainable Agriculture and Eradication of Rural Poverty in Pakistan*, Natural Resources Forum 31 (2007) 253–262, www.ciitlahore.edu.pk/Papers/173 8589019295997357795.pdf(accessed: 20th March, 2014).

4.2.4 Superfluous Legal Documentation of the Loan Transaction

A proper legal documentation is the essence of any loan transaction. If the loan transaction in properly documented according to the law of the land, then the solution of any future dispute among the contracting parties becomes easier for the court of law. The loan documentation typically includes several documents which must be signed by the borrower.[324]

As for as the agricultural financing is concerned, the financial institutions usually follow the same documentation process for agricultural credit as they follow in their normal financing activities. The existing documentation's techniques followed by the financial institutions are objectionable from many aspects. Firstly, as majority of farmers are illiterate[325], so they are not in position to understand the complex type of documentation required by the financial institutions for the advancement of loan. For example the Alfalah Bank Limited, a leading commercial bank, requires the following documentation.[326]

- Copy of NIC
- Photographs
- Agri/Zarie passbook in case of agri land and or title documents in case of residential house, commercial or residential land
- Khasra Gardawri
- Documentation regarding leased inland

---

[324]Paul N. Ellinger and Peter J. Barry, *A Farmer's Guide to Agricultural Credit*, The Center for Farm and Rural Business Finance A Finance-Focused Initiative Providing Information to Farm and Rural Businesses and Their Capital Providers University of Illinois at Urbana Champaign,http://www.farmdoc.illinois.edu/finance/FarmersGuidetoCreditBody.htm(accessed July 18th , 2014).

[325]Mohsin Ali, *Agriculture Problems in Pakistan And their Solutions*, March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013).

[326]The informations are taken from the official website of Bank Alfalah ……….. http://www.bankalfalah.com/(accessed July 20 , 2014).

- 3 years ASV (Average Sale Value) from revenue office /FSV through the banks approve evaluation.
- two personal guarantees
- other documents as per desires

The Zarai Taraqiati Bank Ltd. (ZTBL), a leading specialized institution for financing agriculture usually requires more documents as compared to other commercial banks.[327] The State Bank of Pakistan does not play its role by asking all concerned financial institutions to demand the minimum required documents. But surprisingly, the guideline named Financing Scheme for Small Farmers issued by its Agricultural Credit Department, has ask the commercial banks and other financial institutions to demand the following information from the farmer.[328]

- Meticulous information of his movable (for example tractor, farm implements, car, motor cycle, cattle, other animals etc)
- Immovable property (for example agricultural land, house etc.)
- Income details/ source of income
- The loans secured in the past from financial institutions
- The existing loans which is secured by a farmer from any financial institution.
- The existing status of the above loan
- Detailed description of the purposes for which the above loan was acquired
- Repayment behavior of the farmer regarding the past loans

---

[327]See details regarding collaterals at the official website of Zarai Taraqaiti Bank Limited (Pakistan),http://www.ztbl.com.pk/ (accessed July 20, 2014).

[328] See for example the loan application form given by the State Bank of Pakistan in a guideline for financing agriculture ……………………………..*Financing Scheme for Small Farmers*, Agricultural Credit Department, State Bank of Pakistan,pp9-10 ,http:// www.sbp.org.pk (accessed January,2013).

- Name of the concerned banks from which the previous loan was sanctioned
- Nature of securities deposited with the bank from which the loan was taken
- Outstanding liabilities of the past loan
- Size of a farmer's land which he cultivates
- Size of the land which a farmer(applicant) does not cultivate
- Size of the land which a farmer owns
- Nature of such land (irrigated or non irrigated ,rainy or arid)
- Khatooni number
- Khasra number
- Educational qualification of the applicant

The above information will not be accepted by any commercial financial institution just by filling the same in the loan application form, until and unless supported by approved documents. How it is possible for a local farmer, who works more than ten hours daily in his field, to go for such stiff documentations and their approval? He has enormous duties to be carried out in each harvesting cycle. In addition, he has a social life and, therefore, has so many social responsibilities to be performed. Moreover, majority of farmers in our country are illiterate[329] and this fact further turns the situation from bad to worse.

A critical analysis of all the required documents for agricultural loan reveals the fact that many of such documents are not required for the credit worthiness of a farmer. The reason is that agriculture sector in Pakistan (local farming) usually requires micro finance; and this sort of loan facility can be easily protected by simple requirements. For

[329]Mohsin Ali, *Agriculture Problems in Pakistan And their Solutions*, March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013).

example, the Zarai Taraqiati Bank Ltd. (ZTBL) advances Rs.9, 000/hectare for wheat, Rs.20, 600/hectare for sugarcane, Rs.10, 300 /hectare for rice, Rs. 18,200/hectare for potatoes, Rs.23, 000/hectare for Tobacco etc. [330] The State Bank of Pakistan has developed the following scale for the provision of loan per hectare.[331]

Name of the Major Crop Indicative per Acre Credit Limit

(1)	Sugarcane	Rs. 8,000/
(2)	Paddy	Rs. 4,500/
(3)	Wheat	Rs.4, 000/
(4)	Cotton	Rs.6, 000/
(5)	Potato	Rs.11, 000/
(6)	Tobacco	Rs.9, 000/
(7)	Other Crops	As per actual cost

Table 7: Indicative per acre credit Limit

Source: The State Bank of Pakistan; http://www.sbp.org.pk/acd/appendex-I.pdf(accessed: 22nd July 2014)

In addition some of the researches show that in Pakistan only fifty eight percent of farms are having less than two hectare and they only operate sixteen percent of the

---

[330] Zarai Taraqaiti Bank Limited (Pakistan), http://www.ztbl.com.pk/ (accessed July 20, 2014).

[331] However, this indicative is not conclusive in nature as the State Bank of Pakistan has also authorized all the financial institutions to advance loan over and above the prescribed limit; keeping in view the actual assessment of a farmer's need at the time of lending. These institutions can also augment the amount per hectare based on the credit worthiness of a farmer and the value of security that he can provide. Therefore, it is suggested that all the commercial banks should boost up this amount in order to fulfill the basic needs of a farmer in a better way on one hand , and to play their role in the development of agricultural sector and country on the other…………………………. The State Bank of Pakistan; http://www.sbp.org.pk/acd/appendex-I.pdf(accessed: 22nd July 2014).

farm area.[332] According to Tayyab Safdar, most of the small and marginal farmers are dependent on less than two hectares of land for their livelihoods.[333] Therefore, they are not in need of too much money and require a very small amount to fulfill their various agricultural needs, both for crop and non crop activities.

The above discussion shows that the financial institutions can easily protect their advanced loan without going in unnecessary documentation. It not only creates a multiple technical problems for such institutions but also acts as a hurdle for farmers to get loan facility for the enhancement of their agricultural production. Therefore, very few documents, having indispensable and inevitable nature, should be demanded by the financial institutions like a copy of NIC, photographs, passbook, Khasra Gardawri, etc. All other ancillary type of documentation should be evaded to the last possible extent in order to facilitate a farmer rather than to irritate him. Such shrinking of documentation may act as a driving and motivation force for farmers, particularly that of rural areas to secure loan from such financial institution and fulfill their agricultural needs. On the hand, it may also cut down burden from credit officers who are already working in a very tense environment owing to the fact of human resources' deficiency in financial institutions. In addition, such steps may have very positive effects on the quality of their work.

4.2.5 Lack of Specific Laws for Determination of Interest Rates on Agricultural Loan

The most critical aspect of agricultural finance in Pakistan which is very much criticized by the expert is the rate of interest charged by the commercial banks and other financial institutions. Each and every financial institution charges interest rate according to its own self-made rules and regulations which are directly or indirectly revolve around the philosophy of profit maximization. The financial institutions usually determine such interest rates on the basis of

---

[332] *Smallholder Farming in Transforming Economies of Asia and the Pacific: Challenges and Opportunities*, Discussion Paper prepared for the side event organized during the Thirty-hird session of IFAD's Governing Council, 18 February 2009 http://www.ifad.org/events/gc/33/roundtables/pl/pi_bg_e.pdf(accessed July 21th , 2014).

[333] Tayyab Safdar, *Agricultural Crisis in Pakistan*, Published in The Express Tribune, January 22nd, 2014. http://tribune.com.pk/story/661560/agricultural-crisis-in-pakistan/ (accessed July 21th , 2014).

demand for money and supply of money within an economy.[334] It means that such determination method is not based on logic particularly when the same methodology is applied to agriculture finance. The reason is that agricultural sector is predominantly occupied by the lower class of the society, having very limited resources and piece of land as compared to rich class of farmers.[335] Therefore, there is always a maximum demand for money form the previous class to fulfill their basic agricultural needs. The determination method for the rate of interest, in such a situation is a sort of institutional exploitation of farmers. The absence of proper legal rules and regulations for a uniform scaling of interest rates turn the situation from bad to worse where the financial institutions feel free to set up any interest rate. This situation compels the farmers to avoid financing facility provided by the financial institutions and resort to informal sources of finance like money lenders, relatives, friends, neighbors etc.

In the past too, the most noteworthy issue faced by the farmers all over the world was the high interest rate. For example in case of Pakistan it was floating between 10 to 20 percent and astonishingly 17 percent in Barani Punjab and Baluchistan.[336] The State Bank of Pakistan had given a free hand to all conventional banks to charge any rate of interest in line with their credit policy. In a guideline issued for financing small farmers it was stated, “Bank shall determine mark-up on the basis of KIBOR and their cost of funds in line with their credit policy.”[337] After such authorization how was it possible for a bank to charge low interest rate on agricultural credit, especially when its whole business rested on the concept of profit maximization? Similarly, in Colombia during the 1970s, the rate of even nominal interest rate was floating

---

[334] *How Interest Rates Affect Agricultural Markets,* Alberta.caAgriculture and Rural Development http://www1.agric.gov.ab.ca/$department/deptdocs.nsf/all/sis10122(accessed: 22nd July 2014).

[335] According to a well renowned scholar Rashid Amjad ,Pakistan’s agriculture economy is characterized by an extremely skewed ownership of productive assets, particularly land and water. There are a large number of small, resource poor and subsistence farmers (86 per cent of 6.6 million farm households) who own less than 50 per cent of the land and water resources and a small number of large farmers (14 per cent of the total) owning more than 50 per cent of the resources. About a third of the rural labour force consists of landless labour which together with very small farmers (2 hectares or less), especially tenant farmers tend to be the poorest in the country…………………… Rashid Amjad, *Key Challenges Facing Pakistan Agriculture: How Best Can Policy Makers Respond? A Note,* https:// www.pide.org.pk/pdf/foodsecurity/research/FS1.pdf(accessed: 17th March, 2014).

[336] Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab,* European Journal of Scientific Research,vol.23 no.2 (2008), pp.294-304.

[337] *Financing Scheme for Small Farmers,* Agricultural Credit Department,State Bank Of Pakistan, http:// www.sbp.org.pk (accessed January,2013).

between 10 to 20 percent.[338] The financial institutions justified the charge of high interest rates to high administration cost and rising inflation rates. The administration cost was high as bulk of the farmers were living in the rural areas, and it was extremely hard for these institutions to advance loan without bearing higher cost as compared to the cost involved in normal loans. These financial institutions, in order to reach and provide loan facility to rural farmers, had to open new branches in such areas and increase the number of employees. Researchers rightly observed these facts in their studies on agricultural financing. The statement of Elizabeth Coffey regarding the failure of an agricultural bank, BAP (Banco Agrario del Peru), can be quoted as evidence,

> "Throughout the1970s and early 1980s the number of employees and BAP branches quickly expanded to provide an increasing number of subsidized loans to distant areas (e.g., from early 1975 to late 1979, the number of employees increased by 46 percent). The unpleasant effects of this expansion on the administration costs were compounded by hefty inflation that substantially exceeded the nominal interest rates charged on BAP loans."[339]

Some of the researchers noticed more or less the same constraints in India which prevented the flow of credit to the agricultural sector. In their view, such constraints included the high transaction cost (due to the remoteness of agricultural areas), structural issues in the rural credit delivery system, merit for the issuance of agricultural credit, lack of collaterals in view of low asset base of farmers, low volume of loans with associated higher risks, high man power requirements, etc.[340] Many of the governments, in order to cope with the situation started contemplated ways for the minimization of interest rate after consultation with experts of the field, both from farming and financial institutions. For example, the Colombian government

---

[338]Robert C. Vogel and Donald W. Larson, *Limitations of Agricultural Credit Planning: The Case of Colombia / Les Limites De La Planification Du Credit Agricole: Le Cas De La Colombie*, Savings and Development, Giordano Dell-Amore Foundation ,vol. 4, no. 1 (1980), pp. 52-62.

[339]Elizabeth Coffey, *Agricultural Finance: Getting the Policies Right, Agricultural Finance Revisited*, Food and Agriculture Organization of the United Nations (FAO), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)NO, 2, June 1998,p.5.

[340]Devaraja T.S., (Post Graduate Department of Commerce University of Mysore Hassan, India) *An Analysis of Institutional Financing and Agricultural Credit Policy in India* (The work described in this working paper was substantially supported by a grant from the University Grants Commission of India), May 2011,pp.14-15

initiated a policy of subsidized interest rate in order to maintain the interest rate of agricultural rates below equilibrium level.[341] This facility was specially framed for the deserving small farmers of the rural areas. The subsidies provided by the various governments were of two types i.e. budgeted and implicit. The first type had to appear in the government budgets and included subsidies on fertilizers, weedicides, herbicides, pesticides, insecticides, tube wells etc., while the second type of subsidies was not to appear in the government budgets and included the subsidy on electricity, irrigation water, agricultural credit etc.[342] However, historical facts show that such subsidies produced serious negative effects in one way or the other. For instance, such subsidies were usually paid from the concerned government's budget which would cause deficit in budget and consequently led to increase in inflation.[343] In Turkmenistan, provision of the subsidies had detrimental effects not only on production and productivity but also for the environment and health on parts of Turkmen population where subsidy was provided on irrigation water. The farmers started to use water excessively without any due care for it. This, combined with poor drainage system, led to a rising water table and Stalinization of irrigated land.[344] Even in countries where a proper and careful mechanism was developed for the provision of government's subsidies, these subsidies did not reach the small farmers due to the lack of some technical requirements i.e. lack of securities and collaterals, lack of required agricultural land to be cultivated etc. [345] In most cases such subsidies were given to land lords who were targeted to get benefit from these subsidies. Walter Schaefer-Kehnert and John D. Von Pischke had the same view regarding such subsides as they stated,

---

[341]Robert C. Vogel and Donald W. Larson, *Limitations of Agricultural Credit Planning: The Case of Colombia / Les Limites De La Planification Du Credit Agricole: Le Cas De La Colombie*, Savings and Development, Giordano Dell-Amore Foundation ,vol. 4, no. 1 (1980), pp. 52-62.

[342]Munir Ahmad, Caesar Cororaton, Abdul Qayyum, Muhammad Iqbal , Impact of *Domestic Policies towards Agricultural Trade Liberalization and Market Reform on Food Security in Pakistan*, international Conference on Trade Liberalization and Food Security in South Asia: The Lessons Learnt New Delhi, India, June 8-9, 2006.

[343]Johan F. M. Swinnen, Hamish R. Gow, *Agricultural Credit Problems and Policies During the Transition to a Market Economy in Central and Eastern Europe*, Food Policy 24 (1999),pp 21–47. www.ruralfinance.org/.../1217526012269_agricultural_credit_problems_in_ECA_region.pdf -(accessed March,2013)

[344]Gonzalo Pastor and Ron Van Rooden, Turkmenistan: *The Burden of Current Agricultural Policies,M.E. Sharpe, Inc, Emerging Markets Finance & Trade*, vol. 40, no. 1 (Jan. - Feb., 2004), pp. 35-58.

[345]Johan F. M. Swinnen, Hamish R. Gow, *Agricultural Credit Problems and Policies During the Transition to a Market Economy in Central and Eastern Europe*, Food Policy 24 (1999),pp 21–47.

"Experience also teaches that interest subsidies often have effects opposite to those intended. This is especially obvious in the case of subsidized loans to promote small farm development. According to various studies these subsidies can easily fall into the hands of big farmers"[346].

The statement of Mohammad Rashrash Mustafa would clarify this discussion as he stated,

"Experience indicates that most of the subsidies provided for outputs end up in the pockets of large land owners and investors….This is due to their large holdings (economies of scale), their ability to mobilize larger financial resources for agricultural investment, and the ease in which they are able to obtain modern agricultural technology. This, in itself, will conflict with the principle of fair distribution of income that all economic and social systems strive to achieve, a principle which is intended for providing subsidization to those in need and not to the able and rich".[347]

Due to the reason mentioned above, some of the governments fully eliminated their agricultural credit subsidy programs while others reduced the same to a great extent. For example, in case of Pakistan subsidy on fertilizers was removed after 1996 while subsidy on electricity for agriculture was eliminated in 2002, except in some provinces of Baluchistan, but that too was available as flat rate on agricultural tube wells.[348] In the Near East and North Africa Region various reform programs were launched for the development of agriculture. The experts involved in such projects, called the authorities for lifting all kind of subsidies provided for the

---

[346] Walter Schaefer – Kehnert and Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280, 1982.p.4.

[347]Mohammad Rashrash Mustafa ,*Some Features of Rural Finance in the Near East and North Africa Region - Studies and Remarks* – Amman, Jordan 2004 , Near East North Africa Regional Agricultural Credit Association (NENARACA), 2nd Edition.

[348]Munir Ahmad, Caesar Cororaton, Abdul Qayyum, Muhammad Iqbal ,*Impact of Domestic Policies towards Agricultural Trade Liberalization and Market Reform on Food Security in Pakistan*, international Conference on Trade Liberalization and Food Security in South Asia: The Lessons Learnt New Delhi, India, June 8-9, 2006

irrigation water, chemicals, fertilizers, flour, sugar etc.[349] In short it could be stated that all available subsidies on production, input, and consumer' goods were abolished completely. The arguments of these experts for doing so was that such subsidies squandered resources and frequently reached the hands of rich farmers, being stronger and more influential. Due to exclusion of subsidies program from various governments' agricultural credit policies, their corresponding financial institutions preferred to avoid financing agriculture in its various sectors. The farmers followed up on the same way as it was hard for them to secure loan on high interest rates. They also stayed away from using fertilizers, herbicides, Insecticides, weedicides, pesticides, etc in their fields as these agricultural inputs were no more available in the markets on subsidized rates. This had a dreadful affect on agricultural production in the long term and led to food shortage in various parts of the world.

While summarizing the above discussion, it is recommended that the State Bank of Pakistan should call the legal, agricultural experts and financial institutions' representatives for a long-lasting solution of the problem of high interest rates. They should develop a proper legal mechanism for the determination of interest rate in such way which is acceptable and viable for all stake holders. Being a major and poor class's sector, a special treatment should be given to local farming in this regard. The following guideline issued by the Reserve Bank of India on the same issue can be tracked as a sample.

> "As per the interest rate policy of RBI, interest rates on loans given by commercial banks have been deregulated, except that the interest rate on loans up to Rs 2 lakh should not exceed the Benchmark Prime Lending Rate (BPLR) of the banks concerned. Commercial banks are, therefore, free to decide their lending rates on loans above Rs.2 lakhs, subject to the announcement of BPLR. Banks are also free to lend at sub-BPLR rates to creditworthy borrowers based on an objective and transparent policy, subject to the approval of their Boards. Banks decide their BPLR by taking into account, inter alia, their cost of funds,

---

[349] Mohammad Rashrash Mustafa ,*Some Features of Rural Finance in the Near East and North Africa Region - Studies and Remarks* – Amman, Jordan 2004 , Near East North Africa Regional Agricultural Credit Association (NENARACA), 2nd Edition.

transaction cost and risk cost. As regards RRBs and Co-operative Banks, the interest rates on loans have been completely deregulated"[350]

This policy document clearly shows that all commercial banks in India are subjected to a uniform policy as for as the agriculture sector is concerned and they are not left unchecked to charge any interest rate from farmers. In addition, a special relaxation is given to lower class of farmers by stating that the interest rate on loan above Rs. 2 lakh should not exceed the Benchmark Prime Lending Rate (BPLR)[351] of the concerned bank. It is obvious that lower class of farmers not require more than Rs.2 lakh to fulfill their basic agricultural requirements both for crop and non crop activities.

4.2.6 Lack of Clear Property Rights and Transferability of Title Documents and Pledges

As mentioned earlier that agriculture sector is prone to many risks, both natural and unnatural, and hence the financial institutions are very much reluctant to allocate funds to such sector. In Pakistan, due to the immense pressure from the State Bank of Pakistan, the commercial financial institutions are now duty-bound to look for financing agriculture.[352] A variety of incentives techniques have also used by the central bank for the same purpose. Therefore, the banks start financing those farmers who can fulfill the minimum requirement of securities and collaterals. However, many legal issues have been faced by the financial institutions while dealing with such securities.

---

[350]Information pertaining to Rural Credit, Priority Sector Advances, and Financial Inclusion etc. http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=624 (accessed: 22ndJuly 2014).

[351]The Benchmark Prime Lending Rate (BPLR) shows the interest rate by which a commercial bank lends to its credit worthy borrowers. ……………… http://economictimes.indiatimes.com/understanding-sub-plr-loans/what-is-bplr/slideshow/5022660.cms (accessed: 25th July 2014).

[352]For example, in order to enhance the number of branches in rural areas, the State Bank of Pakistan made it mandatory for all banks (including conventional and Islamic) to open at least 20% of new branches in rural areas of the country. Due to these dynamic policies, the NBP (National Bank of Pakistan) launch 40 new branches in the rural areas……………. Imaduddin, NBP to open 40 new branches in rural areas, Wednesday, 13 March 2013 03:26, Business Recorder, www.brecorder.com › Pakistan › Banking & Finance(accessed: 23th March, 2014).

Firstly, in Pakistan there is no clear property right, particularly in rural parts of the country which is a hub for agricultural activities. Due to the lack of proper legal mechanism of ownership, the banks are not clear about the legal capacity of a farmer based on which he holds the mortgaged property. It is usually very much unclear whether a farmer owns the property or just he controls or benefits from the same, and consequently, the use of land as collateral is discouraged. The following statement given by the ministry of commerce narrates the real picture

> "There is no common record of property rights and transactions in Pakistan. Basic information can be found in the local and district revenue offices. There is the lack of a general property system that could allow continuous updates and modifications and land changes in functions and users and no reliable link between land and proper titles. The government has begun efforts to computerize the land records in pilot projects in Punjab"[353]

The Statement clearly points out that record of land is usually kept by the district government, the administration of which is always characterized for corruption and dishonesty. Therefore, disputes related to land in rural parts of the country is more as compared to that of urban parts. The financial institutions are very much reluctant for advancing loan to a farmer against the mortgaging of his property owing to the fact of vague ownership. It is rightly said by Ghana Susanne Johanna Väth and Michael Kirk that proper property rights have a significant effect on use of the property as a security.[354]

---

[353]*Study on the State of Domestic Commerce in Pakistan*, Study No.9, Real Estate In Pakistan, Ministry of Commerce Government of Pakistan, http://www.commerce.gov.pk/Downloads/Real_Estate_Study.pdf ,(accessed: 26th July , 2014).

[354]Susanne Johanna Väth and Michael Kirk *,Do Contract Farming and Property Rights Matter for Rural Development?* Evidence from a large-scale investment in Ghana institute for Co-operation in Developing Countries, University of Marburg, Am Plan 2, 35032 Marburg, Germany, https://www.uni marburg.de/fb02/makro/forschung/magkspapers/16-2014_vaeth.pdf(accessed: 26th July , 2014.

Secondly, in case of default a financial institution is not in position to recover his liquidity due to the difficult legal process related to the transferability of title documents and pledges. Such legal process is not lengthy in nature but also complex in various aspects, starting from the time of litigation and comes to end at the stage of enforceability. The Banking Companies (Recovery of Loans) Ordinance,1979 (XIX of 1979) and the Banking Tribunals Ordinance, 1984 (LVIII of 1984), The Code of Civil Procedure 1908, the Transfer of Property Act, 1882 and the Contract Act, 1872 are the concerned laws which can be used by a court of competent jurisdiction. Banking Courts is a podium where all banking disputes, particularly those related to the recovery of advance loan, sale of pledge property, foreclosure of mortgage assets etc are solved. In case where a farmer has mortgaged[355] his property, sections 67, 68, 69,70,71,72,73,74,75 of the Transfer of Property Act, 1882 are the relevant sections to be invoked[356]. The section 67 is the main section that provides a mortgagee the right of foreclosure or sale of the mortgage property. According to the section, a mortgagee has a right to file a suit in the court of law whenever his amount becomes due, for the sale of the mortgaged property and prevent the mortgagor from the redemption of the same. However, this right is not absolute in nature and has subjected to certain exceptions mentioned in the same section. Sometime, a mortgagor is not entitled to sue for the foreclosure of mortgaged property and he must have to file a suit for the recovery of mortgage money. This option is taken where the mortgage property wholly or partially has destroyed due to the act of the mortgagor or mortgagee and the property renders insufficient for the recovery of mortgage money. Similarly according to section 67-A

---

[355]A mortgage is a legal contract where one party (the debtor) promises with another (the creditor) to pay the mortgage loan along with interest at a given time mentioned in the contract. The mortgage documents is the record related to the amount due and plus interest. The same document also includes that the mortgagor will pay the legal and other costs incurred by the mortgagee for the collection of loan. When the loan is not repaid, the mortgagee has a right to file a suit in the court of law for the purpose to take back his full or partial payment of the montage debt. It is pertinent to mention that when a mortgage lender requests the court of law for the title of the property, this is called foreclosure. But when he just requests for the sale of the property then it is called "sale" remedy……………… Mortgages: Frequently Asked Questions http://www.lawhelpontario.org/mortgages-frequently-asked-questions/(accessed: 26th July, 2014).

[356] Further details can be derived from the Transfer of Property Act, 1882………………

when the mortgagor binds himself to repay the mortgage money, the mortgagee must have to sue for the recovery of mortgage money. All these exceptions week the general law, where a mortgagee has a right to sue for the foreclosure of the property when his debt is not paid and consequently he financial institutions suffer.

The issue pledge is dealt by the contract Act of, 1872 through its sections 173,174,175,176,177,178 and section 179. According to section 173 when the goods are pledged, the pledgee has right to retain the goods until and unless his principle amount along with interest and his other expenses are not paid. This law becomes very attention-grabbing in nature from many aspects when it is applied to local farming of agriculture sector in Pakistan. Firstly, majority of farmers are not in position to provide assets on the basis of pledge and, therefore avoid loan facility.[357] Secondly, if they pledge some assets and get loan due to some compelling situation, they usually default inadvertently owing to the fact of their financial instability. In such situation, being a major supplier of food; they should be given relaxation rather than to penalize them by charging more than advanced. This law does not seem to be based on the principles of natural justice. The State Bank of Pakistan recommends the same relaxation and advice the financial institutions with the following words

> "The banks/DFIs are allowed to grant relaxation up to one year in repayment schedule, to their borrowers who have been adversely affected due to certain unforeseen and unexpected factors like weather, availability of water, etc. which are not under the control of the farmers. Such relaxation may be granted on case-to-case basis or en-block to the borrowers in the affected area"[358]

However, interest of financial institutions must also be safeguard and intentional defaulters should be filtered in the process of relaxation. Their pledged asset should be

---

[357]M. Taimoor Hassan, Atif Rehman, Attia Rizvi, Rubab Khan,Sunia Ayuub, Uzma Baloch,Bilal Sardar, Muhammad Arfan Lodhi, *Elasticity of Credit Demand in Agriculture Sector in Pakistan*, International Journal of Learning & Development, vol. 2, no. 1, March17, 2012.

[358]*Prudential Regulations For Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

sold after giving a notice for a reasonable time and the amount due should be recovered from the proceeds of the sale. The financial institutions, while doing so, have to fulfill some complex legal procedure mentioned in the Banking Companies (Recovery of Loans) Ordinance,1979 (XIX of 1979) and the Banking Tribunals Ordinance, 1984 (LVIII of 1984). This legal procedure can be summarized in the following words.[359]

> "When a debtor (customer/borrower/customer) commits a default, then the financial institutions may institute a suit in the Banking Court by presenting a plaint properly signed by its Branch Manager or any other person (authorized by the concerned financial institution). All supported documents should also be attached with the plaint for the purpose of solid evidence. A reasonable number of copies of plaint should also be submitted, so the court may provide the same to all concerned parties. After the institution of suit, the banking court summons the defendant according to Form No.4 in Appendix 'B' to the Code of Civil Procedure, 1908(Act V of 1998) or any other form as may be described bylaw from time to time. As required by the law When the summon is served, the defendant is not entitled to defend the suit unless and until he seeks permission from the Banking court in this regard. If the defendant fails to do so, the Bank court may consider that all allegations mentioned in the plaint have been admitted and a decree in favor of the plaintiff may be passed. In case where the defendant satisfies the court that his delay was due to some inevitable reason, the court may consider his request and may permit him to defend the allegations against him. If the Banking court considers, after a profound study of the contents of the plaint and response of the defendant, that the dispute between or among the parties does not extend to the whole of the

---

[359]*The State Bank of Pakistan Order , 1948*, State Bank of Pakistan,pp3,4 http://www.sbp.org.pk/about/sbpact/sbpact1.htm(accessed:29th July , 2014).

> claim but related to a part of it, or the dispute is only related to the arte of interest, then it can pass an interim decree in respect of that undisputed portion or amount…………..,."

The above procedure shows the time consuming nature of litigations in case of default by a customer, followed by the foreclosure and sale of his mortgaged and pledged property respectively. There are many other steps in such procedure which though not discusses, however they are indispensably followed e.g. statement of a witness who have signed the loan transaction, cross examination, critical analysis of documentary evidences etc. The technical nature of such legal process create hurdle for a farmer majority of who are ignorant.[360] The above legal process also compels the financial institutions to think hundred times before financing agriculture. Some of the well renowned researchers in the field of agricultural finance have the same view regarding the legal process (at international level e.g. Albania, India, Pakistan, Senegal, Thailand, Tunisia) in the following words

> "More generally, in many countries the legal environment does not foresee the pledging of movable assets, leaving banks unsure if they can foreclose on such items in case of default. This is one of the main reasons why financial services such as equipment leasing, inventory financing, invoice discounting and factoring (entirely normal in developed markets) do not take off in developing countries. Thus, in view of their existing risk management policies and national regulations, many banks cannot finance agriculture other than some large, diversified agricultural enterprises with related processing and distribution capabilities and solid guarantees. This is precisely what was seen in the six countries studied, with the exception of Thailand, which is able to reach out to smallholder farmers through BAAC"[361]

---

[360] In the view of Mohsin Ali majority of farmers in Pakistan are illiterate …………………..Mohsin Ali, *Agriculture Problems in Pakistan and Their Solutions*, March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013).

[361] Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms,

The above statement evidently discusses the whole issue in a summarized form. It is therefore, it is suggested from the government to ask the State Bank of Pakistan to recommend such rules and regulations for financing agriculture through experts in order to create an appropriate legal and regulatory environment.

4.2.7: Lack of Less Formal Mechanism for the Resolution of Dispute.

The procedure mentioned in the above lines clearly demonstrates the length of time taken by the litigations related to agricultural finance. Besides the time consuming nature, such litigations also put burden not only on financial institutions but also on weak shoulders of farmers. The reason is that whenever a farmer defaults, the litigation expenses are added to the amount due. In short, the formal mechanisms for the dispute resolution affect negatively the farmers' community by one way or another. As a result, they intentionally avoid getting formal loan and resort to informal finance through the money lenders, relatives, friends, neighbors etc.

There is a tense need to develop a less formal mechanism for the resolution of agricultural financing's dispute. This idea is supported by many researchers, who are familiar with the field of agricultural finance, in their work. For instance, Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms in their collective research emphasis on less formal institution for the resolution of dispute between farmer and financial institution like arbitration. However, they advise that nature of disputes should be kept in mind while deciding a less formal mechanism for its resolution.[362] By the nature of dispute such scholars means the complexity of the case and the amount involved therein. They also recommend some special commercial courts for the same purpose in order to solve the agricultural finance disputes on prompt basis.

In some countries the agricultural disputes are resolved through mediation. A leading country in this regard is the United States where 37 States have already started agricultural mediation

---

Creating Access to Agricultural Finance Based on a horizontal study of Cambodia, Mali, Senegal, Tanzania,Thailand and Tunisia, July 2012,p.24,capacity4dev.ec.europa.eu/.../creating_access_to_agricultural_finance.*pd*(accessed July 16, 2013)(The A Savoir collection was created in 2010 by AFD's Research Department and gathers either literature reviews or existing knowledge on issues that present an operational interest. Publications in this collection contain contributions based on research and feedback from researchers and field operators from AFD or its partners and are designed to be working tools. They target a public of professionals that are either specialists on the topic or the geographical area concerned).

[362] Ibid, p.84.

program.[363] In the State of Utah and the State of New Jersey the mediation programs are running very successively. Similar is the case of New South Wales (a state in Australia) where a full pledge legislation is made on farm mediation i.e. Farm Debt Mediation Act, 1994, No.91.[364] The Act is so active in nature that a creditor can not sell or foreclosure the pledge and mortgage property without serving a notice to a farmer for mediation.[365] According to the Act if both the parties to the contract (creditor and farmer) agree at the inception of contract to resolve their dispute related to agricultural credit in future, then the farmer, in this case, must nominate a mediator. The following 3 subsections of Section 12-A (of the Act) can be presented as solid evidence for the importance of mediation in the legal statement

"(1) if a farmer and creditor agree to enter into mediation in respect of a farm debt, the farmer must nominate a mediator.

(2) A creditor cannot nominate a mediator but must accept or reject the mediator nominated by a farmer.

(3) If a creditor rejects the mediator nominated by a farmer, the farmer must nominate a panel of at least 3 other mediators. The creditor must choose from the panel one mediator to mediate between the farmer and the creditor."

Both the parties have a conclusive freedom whether to go for mediation or not, however, the alternate dispute resolution mechanism is existing since last two decades and benefit can be taken from it very easily.

Arbitration's law is available in Pakistan in the shape of Arbitration Act of 1940 and hence it is open to all citizens without any sort of discrimination to go for the resolution of their dispute through this less informal, cheaper and less time consuming mechanism. The citizens, indeed, include farmers as well as financial institutions (being juristic person) and, therefore, can take benefit from this forum for the solution of their agricultural disputes. The only requirement is

---

[363] *New Jersey Agricultural Mediation Program Handbook*, a Guide for Farmers, Neighbors and Municipalities, N.J Agricultural Development Committee,p.1,http://nj.gov/agriculture/sadc/agmediation/handbook.pdf(accessed: 30th July , 2014).

[364] For further details of the Act please see ………..Farm Debt Mediation Act 1994 No 91, http://www.raa.nsw.gov.au/__data/assets/pdf_file/0005/275666/farm-debt-mediation-act.pdf (accessed: 30th July, 2014).

[365] See for example Section No.8,Subsection 1 , Part 2 for Mediation of Farm Debt Mediation Act 1994 No 91,

that they must have to enter into a written agreement in the beginning of loan transaction that they will resolve their dispute through an arbitrator (whether named or not in the agreement according to section 2, sub section.2).[366] However, it is appropriate to appoint one arbitrator from farmers' community and the other is a nominee from the financial institution as there is no restriction (according to Section 8 of the Arbitration Act, 1940) over the number of arbitrators. The option of arbitration can be availed by three ways:

1: Arbitration without intervention from the court of law as discussed in Chapter No.2, Sections 3 to 19. This option is more suitable to be availed by the farmers and financial institutions particularly in less complex situation or where a less amount of loan is involved. The reason is that court's involvement indispensably brings the issue of time consummation, cost and intricate procedure. In addition, appointment of one arbitrator, in such situations, is more appropriate as compared to the appointment of two or more. In other words, micro-financing activities in agriculture; particularly in rural parts of the country, should be regulated through this option.

2: The option where no suit is pending and the appointment of arbitrator is made by the court while using its power mentioned in Section 18 of the Act. In such a situation, the parties are asked to appoint arbitrator and in case of their failure the court will appoint arbitrator. As for as the agricultural finance is concerned, this option will be availed where there is a difference between a farmer and financial institution regarding any aspect of arbitration. However, here some special and simple procedure should be recommended and the general procedure mentioned in Section 18 of the Act should be avoided to the possible extent.

3: The option where a suit is pending before the court of law, and the parties put a request before the court of law (under chapter.4, Sections 21, 22.23,24 and 25 of the Arbitration Act, 1940) for the appointment of an arbitrator. As for as the agricultural finance is concerned, this option will be availed in those agricultural loan transaction cases which are already pending before the court of law since long time. This is the best option where a farmer and a financial institution can get rid and avoid the complex and time consuming procedure of the court of law

---

[366]For further details of the concerned law please see the Arbitration Act, 1940………… http://www.ma-law.org.pk/pdflaw/Arbitration%20Act,%201940.pdf(accessed: 30th July, 2014).

The above line shows that the law of arbitration can be effectively used for all sorts of conflicts related to agriculture finance; immaterially when such conflicts are brought before the court of law for the purpose of settlement or not. It is the responsibility of the government as well as of the central bank to increase awareness of farmers and financial institutions regarding the beneficial use of arbitration.

The concept of mediator can also be used for the solution of agricultural credit disputes. This method is even more useful, very much less formal and effective as compared to the concept of arbitration.[367] In this case a farmer and a financial institution can hire the services of another farmer (as a mediator) of the same region. Even a senior banker can also be nominated for the same purpose. The issue must be brought before such a farmer or banker (in the capacity of a mediator) for mediation on priority basis, and in case, when the mediator fails and does not reach to a settlement, then the parties may go for arbitration and other formal process. It is need of the time that the government (of Pakistan) gives a legal cover to the mechanism of mediation through a proper legislation as it has provided in the case of Jirga's decisions through The North-

---

[367] Arbitration and mediation are the same in terms of their basic purpose i.e. a fair resolution of disputes. However, there are also some major differences between these two concepts. Firstly, in the process of arbitration, the arbitrator hears evidences based on due process of law and make the decision accordingly. The mediation on the hand is just an assistance provided by a third party in the process of negotiation. The mediator here can not decide any thing unless the concerned parties become agree over the same. Secondly, in arbitration, the arbitrator issues orders, finds faults and make determinations unlike a mediator who wants to settle the issue among or between the parties by obtaining relevant information regarding the dispute. Thirdly, an arbitrator does not meet the concerned parties to dispute separately and both are heard in the same session while mediator usually meet with the parties individually and collect information in respect of their grievances. It is happening very much commonly that a mediator goes back and forth between the concerned parties a number of times, convincing both on a possible solution of the issue. In other words, a mediator is more enthusiastic than an arbitrator as for as the solution of the issue is concerned. Fourthly and more importantly, a legal assistance is provided to an arbitrator all most in all developed and progressive legal system in order to minimize burden from the shoulders of judiciary. While the same back up is not available to a mediator who solely resolve the dispute owing to the fact of a social member of the society. Fifthly, arbitration is more formal process than mediation. The arbitrator may be a retired judge of high reputation, a senior level advocate, or a professional such as a doctor, an engineer, an accountant etc. During the process of the case, both parties are properly heard, their lawyers are given the opportunity to present evidences and witnesses just a like a regular court do. They are also given an opportunity to question and cross examine each others witnesses. After hearing the concerned parties, the arbitrator renders a decision which is binding in nature on all concerned parties. In the process of mediation, on the other hand, none of such formalities are followed ……………………… for further details please see ……… British Columbia International Commercial Arbitration Centre, Difference between Arbitration and Mediation http://bcicac.com/about/what-is-mediationarbitration/difference-between-arbitration-and-mediation/ (accessed: 3rd August, 2014).

West Frontier Province Civil Procedure (Special Provisions) Act, 1977.[368] If the Jirga system can be applied to solve the tenancy disputes mentioned under section 7 of the North-West Frontier Province Tenancy Act, 1950 (N. W. F. P. Act XXV of 1950), then it is a valid question comes to the mind of a vigilant reader that how such system can not be applied to the solution of other agricultural disputes with the same effects? The rural agricultural financing can be regularized more effectively through such local legal mechanism i.e. the Jirga system[369]

4.2 Economic Analysis of Formal Financing in Pakistan:

The formal financing of agriculture have some specific economic purposes which must be cared by the financial institutions while making a mechanism, structure, rules, regulations, policies etc for agricultural credit. These purposes consists of, broadly, both agricultural and non agricultural. The previous includes augmentation in agricultural production, replacement of old and weak farming practices with new one etc. While the latter takes account of various effects having by agricultural credit on farmers' life i.e. increase of literacy rate in farmers and in their offspring, positive change in their living standards, increase in income to such extent that they may not ask for further credit, poverty reduction, increase in tax revenues, increase in export etc. The major economic aspects, from the above, are discussed thoroughly in the following lines.

---

[368]The government of Pakistan has introduced the North-West Frontier Province Civil Procedure (Special Provisions) Act, 1977 in order to give a legal support to Jirga system in Pakistan. The Act has rendered many powers to Jirga and authorized it to adjudicate all suits filed by a landlord for arrears of rent or the money equivalent of rent, or any sum recoverable under section 7 of the North-West Frontier Province Tenancy Act, 1950 (N. W. F. P. Act XXV of 1950) . It is also empowered to adjudicate all types of civil nature cases according to the provision of the Act. According to section .6 of the Act, the Jirga shall be composed of a Government official as a president of the Jirga, not below the rank of Tehsildar or Naib Tehsildar (exercising the powers of Tehsildar) and two other members who are appointed by the Deputy Commissioner on the basis of their integrity, education, social status etc. No member of the Jirga, except the president, can be appointed by the Deputy Commissioner without hearing the disputed parties whether they have any objection over the appointment of any member. If the Jirga fails to decide the issue between the concerned parties, the Deputy Commissioner can constitute another Jirga , comprises of different members………………….for further details of Jirga laws can be traced back in the Act known as the North-West Frontier Province Civil Procedure (Special Provisions) Act, 1977………….. http://www.khyberpakhtunkhwa.gov.pk/Gov/Details.php?id=330 (accessed: 3rd August, 2014).

[369] It is pertinent to mention that the North-WestFrontier Province Civil Procedure (Special Provisions) Act, 1977 has been abrogated by the Government of Khyber Pakhtunkhwa (KPK) and hence the code is no more enforceable. Here the code is just discussed for the purpose of guidance towards the solution of agricultural finance issue.

4.2.1 No Raise in Farmers' Financial Abilities

The first and the most important purpose of agricultural credit is to improve economic condition of farmers. The financial institutions, particularly those involved actively in agricultural finance, directly or indirectly claim the fulfillment of the same purpose in their annual reports. The annual reports of the Zari Taraqiati Bank of Pakistan can be cited as a typical example in this regard.[370] However, the situation is entirely different at ground level. The following lines can draw a clear picture of such claims.

Study of many researchers in the field of agricultural finance reveals that rural household, in case of Pakistan, can be classified as poor or below poverty line.[371] In the view of Imran Sharif Chaudhry, Shahnawaz Malik and Muhammad Ashraf, poverty in rural area is more than the poverty level in urban areas of Pakistan due to factors of inflation, unemployment and growth rates.[372] According to them the remedy lies in the creation of various opportunities related to investment, entrepreneurship, jobs etc. Abdul Waheed Bhutto and Aqeel Ahmed Bazmi posit that poverty has spread over in the rural areas of Pakistan where majority of people are deprived from their basic needs i.e. stable income, clothing, housing, health care, education, sanitary facilities and human rights. A major portion (nearly 65.5 percent) of the population in such areas is directly or indirectly dependent on agriculture.[373] Agriculture for this majority remains as a source of life, not a business activity for earning profit. Rashid Amjad,[374] a well renowned economist, states:

---

[370]See annual reports of the Zari Taraqiati Bank of Pakistan for the years of 2006, 2007, 2008,2009,2010,2011 and 2012………………… http:// www.ztbl.com.pk/(accessed August, 2014).

[371]Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, vol. 38, no. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716.

[372]Imran Sharif Chaudhry, Shahnawaz Malik, Muhammad Ashraf,*Rural Poverty in Pakistan Some Related Concepts, Issues and Empirical Analysis,*Pakistan Economic and Social Review vol.44, no. 2 (Winter 2006), pp. 259-276.

[373]Abdul Waheed Bhutto ,Aqeel Ahmed Bazmi, Sustainable Agriculture and Eradication of Rural Poverty in Pakistan, Natural Resources Forum 31 (2007) 253–262, www.ciitlahore.edu.pk/Papers/173 8589019295997357795.pdf(accessed: 20th March, 2014).

[374]The author was a vice Chancellor, Pakistan Institute of Development Economics and Chief Economist, Planning Commission, Government of Pakistan.

> “Pakistan's agriculture economy is characterized by an extremely skewed ownership of productive assets, particularly land and water. There are a large number of small, resource poor and subsistence farmers (86 per cent of 6.6 million farm households) who own less than 50 per cent of the land and water resources and a small number of large farmers (14 per cent of the total) owning more than 50 per cent of the resources. About a third of the rural labour force consists of landless labour which together with very small farmers (2 hectares or less), especially tenant farmers tend to be the poorest in the country”.[375]

The failure of agricultural credit to bring prosperity in farmers' life is not confined to the boundaries of Pakistan rather it goes beyond it. Latin America, for example, had the same situation.[376] Similarly, in case of India 185 millions from the population is poor and related to agricultural sector, directly or indirectly. [377]

The aforementioned reveals that majority of farmers in the whole world (as well as in Pakistan) belong to the lower class of the society and need to be assisted financially by the Islamic banks, Islamic financial institutions, and conventional financial institutions through a proper revival of their existing financing polices. The case of Pakistan is not much different from the rest of the world, in terms of credit policies, and here too the rural population is dependent on agriculture and is deprived of basic life facilities.

Due to the reasons above, majority of farmers are not in a position to pay off the borrowed amount; and find their names in the defaulters list issued by financial institutions. In case of provision of agricultural credit, they are certain to face liquidity problems at the time of repayment. It shows that existing agricultural credit does not enhance a farmer's financial status rather it put more burden on his weak shoulder. It is an astonishing fact that refinancing concept

---

[375]Rashid Amjad, *Key Challenges Facing Pakistan Agriculture: How Best Can Policy Makers Respond?*A Note, https:// www.pide.org.pk/pdf/foodsecurity/research/FS1.pdf (accessed: 17th March, 2014).

[376]Dale W. Adams, Agricultural Credit in Latin America: *A Critical Review of External Funding Policy*,American Journal of Agricultural Economics,vol. 53, no. 2 (May, 1971), pp. 163-172,

[377]*Strengthening Agricultural support Services For Small Farmers*, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

has been discovered by financial institutions, knowingly that contemporary agricultural financing can not bring any mentionable change in a farmer' economic stability. Such refinancing schemes show unambiguously failure of agricultural loan.[378]

In the above situation, the financial institutions (in Pakistan) do not ponder over the revival of their loan schemes to strengthen economic position of farmers rather some strict strategies are adopted for the recovery of agricultural loan. For example, 96% of agricultural loan is disbursed against pledge and mortgage, keeping in mind the meager economic condition of farmers and consequently their default.

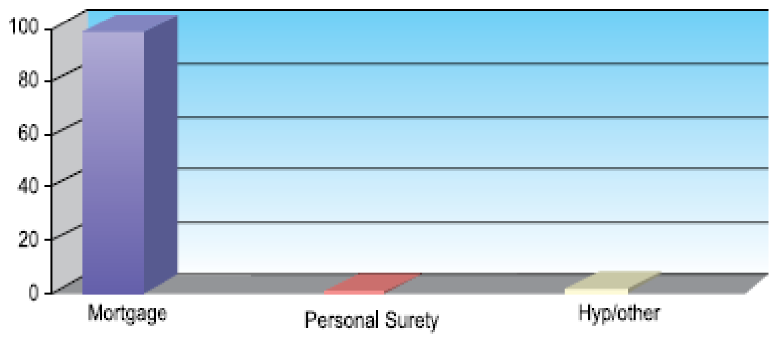


Figure 2: Disbursement of loan on the basis of various types of securities.

Source: Annual Report 2012, the Zari Taraqiati Bank of Pakistan, p.34

This approach has breached the explicit prudential regulations of the State Bank of Pakistan for the provision of unsecured loan to agriculture.[379]

---

[378]The Zari Taraqiati Bank of Pakistan in its annual report for the year of 2012 has discussed the concept of "Agri. Refinancing Schemes for Revival of Agricultural Activities in Flood Affected Areas" .In compliance with the policy of the Federal Government and State Bank of Pakistan the scheme has launched, initially, for selected districts notified by the National Disaster Management Authority (NDMA). The bank has allocated initially Rs.3, 000 million to the concerned districts. The scheme is launched for the purpose to help out the flood affected farmers but unpredictably the rate of interest has also imposed on such loan to the extent of 8 percent. However, in case of default, a farmer has to pay 13 percent over the principal amount. This fact shows that even a specialized financial institution for financing agriculture advances loan for its profit maximization and not for the benefit of farmers, even in catastrophic like flood, storm, earth quake, hail storm etc ………………… The details of the scheme can be found in Annual Report 2012 of the Zari Taraqiati Bank of Pakistan,p.36, http:// www.ztbl.com.pk/(accessed August 9th, 2014).

This dilemma, however, is not limited to the financial institutions in Pakistan and some other countries' financial institutions have also demand for high collaterals in agricultural credit For instance, in Nigeria court action against the defaulter, sale of collaterals, holding guarantors, use of license debt collectors, publication and announcement of defaulters' names in newspapers and radio, use of arbitration panel and task force, purchase of defaulters' farm produce, appealing to defaulters' village heads organizations and religious group, denial of social and membership right, reduction in interest charges, use of thugs against defaulters are some of the measure carried out.[380] These tactics have proved vital for the financial institutions but on the other hand have tainted the farmers' tendency towards the agricultural credit in the negative line. They start to avoid securing loan particularly from the formal institutions as many of these strategies are humiliating in nature. For example, announcement and publication of defaulters' name in electronic and print media is not justifiable under any stretch of explanation. The financial institutions have a tendency to avoid the recovery of loan through judicial process (which is the most respectable way for the recovery of loan) as this requires a good amount of time and expense.[381] All these steps have forced the farmers to secure loan from informal sources. In Tanzania 80% of the population secure credit from the relatives.[382] Walter Schaefer-Kehnert and John D. Von Pischke appropriately say "Although reliable data are lacking, there are indications that a large proportion of the rural credit in developing countries is provided by

---

[379]The State Bank of Pakistan has Issued Financing Scheme for Small Farmers on group based lending methodology whereby members of the group can borrow up to Rs 200,000/- without any collateral from financial institutions……………..see for details *Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22nd March, 2014).

[380]Aja Okorie and Andrew C. Iheanacho, *Agricultural Loan Recovery Strategies In A Developing Economy: A Case Study of Imo State, Nigeria,* African Review of Money Finance and Banking, No. 2 (1992), pp. 195-202, http://www.jstor.org/stable/23027471,(accessed: April 6,2013)

[381]Ibid, pp. 195-202.

[382]Mats Lundahl and Lucian A. Msambichaka, *Agricultural Credit in Tanzania 1961-1966 / Le Crédit Agricole En Tanzanie1961-66*, Savings and Development, vol. 13, no. 2 (1989), pp. 149-168.

non-institutional sources[383]. The case of Pakistan is no different where 85 percent of the credit is provided by informal sources too.[384]

While summarizing the whole discussion, it can be easily concluded that meager economic conditions of farmers, particularly of those living in rural areas, has declined the growth of agriculture and its various sectors; importantly local farming and live stock. This requires a consistent attention and support from the government to create options for enhancing the economic conditions of rural farmers which may include proper legislation for financing agriculture, development of infrastructure, introduction of new agricultural technologies, provision of subsidies on agricultural credit and basic agricultural inputs, new methods for risk management, awareness regarding financial services, construction of roads bridges, opening of specialized rural financing bodies like rural banks etc. By these concrete steps, the rural farmers' financial status can be enhanced and consequently his life standards. While achieving this goal, a farmer may not be in need of any refinancing facility when he is financed only once!

4.2.2 No Change in Weak and Old Farming Practices:

Another important purpose of agricultural finance is to replace the old farming techniques with the new one in order to increase the arte of production. The financial institutions are duty bound to take two steps in this regard. Firstly, they should create awareness among the farmers (the customers) regarding the new prevailing techniques of farming, opted by the farmers of developed countries. This would be very helpful to cope with the menace of food shortage, mainly caused by the old farming methods i.e. imbalanced use of fertilizers,[385] improper

---

383 Walter Schaefer – Kehnert and Jhon D.Von Piodike "*Agricultural Credit Policy in Developing Countries*", World Bank Re Print Series: Number 280, 1982.p.4.

384 Winfried Manig ,*The Importance of the Informal Financial Market for Rural Development Financing in Developing Countries*: *The Example of Pakistan*, The Pakistan Development Review 35 : 3 (Autumn 1996) pp. 229—239.

385 The most important reason thus, for the food shortage is the traditional farming methods that badly affect the rate of yield and production per acre. There are various mistakes committed by the farmers, particularly of rural areas, at various stages of farming owing to their unawareness about contemporary methods of farming (This idea has been taken from …………Pakistan Agriculture, Country overview overview, Jaffer Ago Services,http://www.jaffer.com/BusinessUnits/JAS_Agriculture_Pakistan.aspx (accessed: 5th April 2014).For instance, such farmers are using fertilizers in a very imbalanced manner in the sense that they focus more on nitrogen and less potassic fertilizers.(Fertilizers are various chemical compounds which contain nitrogen, phosphorous, sulphur, sodium that are essential for the development and growth of crop. The basic function of such

irrigation methods, etc. They should be advised to leave the traditional techniques which are not useful in the modern day farming.[387] This awareness can be created through the publication

---

fertilizers is to make up deficiency of soil and keep it neutral. Such fertilizers can be divided into various classes mainly based on their function and chemical nature i.e. mineral fertilizers and organic fertilizers. The mineral fertilizers are subdivided into nitrogenous fertilizers, potassic fertilizers and phosphatic fertilizers………… see for details Fertilizers, Types of fertilizers http://www.citycollegiate.com/industry1.htm (accessed: 5th April 2014) This imbalance causes deficiency of potassic and consequently affects the rate of production. Similarly, these farmers are not in a position to use water properly, despite the fact that water shortage for irrigation purposes is increasing day by day. It is said that water availability has dropped from about 5,000 cubic meters per capita in 1950s to less than 1,500 m3 per capita today(Pakistan Agriculture, Country overview overview, Jaffer Ago Services,http://www.jaffer.com/BusinessUnits/JAS_Agriculture_Pakistan.aspx (accessed: 5th April 2014).All above mentioned problems can be solved through the inculcation of new methods of farming in the agriculture sector both for crop and non crop activities. For example organic farming should be adopted for rapid increase in production. Such methods of farming include crop rotation, green manure, biological pest control, mechanical cultivation, compost etc. Similarly, the multi crop farming is more suitable in rural areas of the country and hence should be followed. In this method two different crops are produced in a single season. The second crop is planted after the harvest of the first one; or is planted at the mid stage of the first crop. Some farmers use another technique for multi crop purpose. For example, they plant an additional crop in the spaces available of the main crop. This method is called inter-cropping in the local language.

[386]The proper irrigation methods play a vital role in the increase of agricultural production. In rural areas of the country (Pakistan), unfortunately the lack of awareness regarding appropriate irrigation methods has decreased the yield per acre. The local farmers either provide too much water to a plant, more than it needs, or provide less than the required. There is no method for the determination of efficient use of water. It is the need of the time to arrange training facilities for farmers, particularly those of rural areas, in order to educate them regarding the new methods of irrigation. These methods include centre –pivot (automated sprinklers irrigation), drip method (a planned irrigation system in which water is applied directly to the Root Zone of Plants by means of applicators), flood method (where the entire surface of the soil is covered by pond water), furrow method, gravity method (in which the water is not pumped but flows and is distributed by gravity), rotation (where the water is provided at stated intervals) sprinkler method (where the water is applied by means of perforated pipes or nozzles operated under pressure so as to form a spray pattern), sub- irrigation method, traveling gun method, supplemental method (which ensures increase in crop production areas where rainfall normally supplies most of the moisture needed), surface method etc(Some irrigation methods (This information is courtesy of the Nevada Division of Water Planning), The USGS Water Science School, https://water.usgs.gov/edu/irquicklook.html(accessed: 5th April 2014).

[387]The farmers areusually unaware about new ways and techniques of modern farming. Modern methods and techniques are very helpful for increase in production par acre and thus through their use the food shortage at international level can be decreased to a great extent. The classical methods are used by farmers which are not useful in the modern times due to the many reasons. (1) In ancient times demand for food was not so high. However, Due to tremendous increase in population, the international community is now facing severe food shortage. In the view of some researchers, half of the world population is currently affected by food deficiency (Eric Holt-Gim nez, The world food crisis: what is behind it and what we can do, http://www.worldhunger.org/articles/09/editorials/holt-gimenez.htm(accessed July 30, 2013); (2) In the past, the agricultural products were limited to few kinds i.e. maize, rice, wheat, sugarcane etc. All these products could be produced through the simple methods of local farming. In modern times new agricultural products are introduced thorough biological experiments to cope with the food shortage problem. (3)In the modern times agricultural products are used in a variety of food products. Now wheat (which is one of the top three crops grown all over the world) is not only used for local bread but is rather a source

of small booklets, arrangement of workshops and training, communication of information by the way of electronic and print media etc as did by the State Bank of Pakistan in the case of rural and agricultural financing awareness program.[388] Secondly, and more importantly, the financial institutions have to allocate enough liquidity for agricultural credit so the farmers may purchase the new equipments; indispensable for the inculcation of new techniques.

The financial institutions, however, fail badly in the fulfillment of these duties. They are not concerned, even to a minor extent regarding the introduction of new farming practices in agriculture. These institutions even do not think to create awareness among its customers (farmers) regarding the adaptation of new methods. There are many reasons responsible for this kind of approach. Firstly, creation of awareness can be made through various ways i.e. publication of booklets and brushers, arrangement of training and workshops through agricultural experts, communication through electronic and print media etc. All these steps require a good deal of money by one way or another; and the financial institutions are not ready for doing so under any concept or philosophy of Corporate Social Responsibility (CSR). Secondly, these financing institutions do not consider financing agriculture a viable option and, therefore, do not want to be actively involved in the same. They advance loan to agriculture (with no intention of

---

of many products i.e. flour, baked goods, pasta, pizza, cereals, canned soups, sauces, dip and gravy mixes, instant drinks, deserts, ketchup, sweets and etc (20 Common Foods Containing Wheat, http://www.3fatchicks.com/20-common-foods-containing-wheat/(accessed: 2nd April 2014).Similarly rice is not only cooked at local level but is used in a number of products like rice cake, baby cereals, rice gruel, rice noodles, kaset rice etc. Because of this reason, demand for these basic agricultural products has increased rapidly in the last half of the 20th century. This demand cannot fulfill with the use of classical methods of farming.;(4) The distribution of land through the law of inheritance is a major cause for the shortage of food at international level. The reason is that by inheritance the land is cut down into small pieces and this affects its productivity to a great extent. Some of the scholars like Paul Francis, share the same view by stating, "The division of land upon inheritance leads to holdings becoming uneconomic in size and productivity(Paul Francis,Humid Zone Programme ILCA, P.M.B. 5320, Ibadan, Nigeria, No. 24–March 1986. http://, www.ilri.org/InfoServ/Webpub/fulldocs/Bulletin24/Land.htm(accessed: 30th March, 2014)The farmer's strategy is to get maximum production from his small piece of land (usually below the substantive level) and this goal cannot be achieved through former classical methods of farming. The use of new techniques of farming is indispensible.

[388]Moreover, the central bank has published brochures about various loan schemes and has translated the same into Urdu and many local languages. Some training programs are also organized in collaboration with various commercial banks for the purpose to create awareness among the farmers regarding various loan schemes and to increase capacity of commercial banks in agricultural and rural finance through the training of their corresponding agricultural credit officers……………See for details….*Handbook on Best Practices in Agri/Rural Finance,* Agricultural Credit Department, State Bank of Pakistan, pp7-8,, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

its development) just to meet SBP policy directives related to agriculture sector.[389] Ahmad Fraz Khan has the same observation, while discussing the six-step plan of the State Bank of Pakistan

> "One should also not forget that all these banks advance agriculture loans on commercial, not subsidized rates. They avoid agriculture loaning only because borrowers are farmers of smaller means, as compared to that of industry, and the banks have to deal with a long list of clientele. This is hardly a sound reason for the State Bank of Pakistan to let commercial banks ignore its agenda for agricultural growth".[390]

The statement shows that financial institutions advance loan to agriculture in a compelling situation i.e. just to comply with the prudential regulations of the central bank, and not on their own free will and determination. This fact has really detoriated the real sprit of agricultural finance. But if the loan is advanced through the immense pressure of the State Bank of Pakistan, that too is very small and not enough for the purchase of type of seeds, fertilizers, herbicides, tools etc, necessary for modern farming practices. The State Bank of Pakistan has observed the same situation by stating

> "The farmers, particularly the small farmers are facing problems in early adoption of new technologies because of financial shortages. Facilitation to this sector, by expanding agricultural credit at the grass root level is a credible effort towards economic and rural development."[391]

4.2.3 No Impact on Farmer's and His Offspring Literacy Rate:

The existing financial system followed by the commercial banks for the development of agriculture does not capable of bringing the underlined objectives. Among these objectives, enhancement of farmers' and their decedents' literacy rate enjoys a top priority. The reason is that if a farmer is educated, this fact must pave a way for other economic development related to

---

[389]Rashid Faruqee, *Strategic Reforms for Agricultural Growth in Pakistan, Improving Rural Finance*, World Bank Publications, 1999, p.123.

[390]Ahmad Fraz Khan ,*Skewed agricultural loans*, The Dawn News, Published Feb 24, 2014 07:41am, http://www.dawn.com/news/1089051(accessed: 10th August , 2014).

[391]*Financing Scheme for Small Farmers*, Agricultural Credit Department Islamic Banking Department State Bank of Pakistan(accessed: 28th February , 2014).

him directly or indirectly. The statement of Rosalyn McKeown can explain comprehensive the theme under discussion.

> "Research has shown that education can improve agricultural productivity, enhance the status of women, reduce population growth rates, enhance environmental protection, and generally raise the standard of living. But the relationship is not linear. For example, four to six years of education is the minimum threshold for increasing agricultural productivity. Literacy and numeracy allow farmers to adapt to new agricultural methods, cope with risk, and respond to market signals. Literacy also helps farmers mix and apply chemicals (e.g., fertilizers and pesticides) according to manufacturers' directions, thereby reducing the risks to the environment and human health. A basic education also helps farmers gain title to their land and apply for credit at banks and other lending institutions. Effects of education on agriculture are greatest when the proportion of females educated to threshold level equals that of males"[392]

The statement shows that educating farmers can bring positive change in agriculture sector from many aspects. These include

- Increase in agricultural productivity
- Awareness of environmental protection
- Positive change in life standards of farmers
- Adoption of new agricultural methods
- Methods for risk reduction
- Respond according to market behavior

---

[392]Rosalyn McKeown, *Education for Sustainable Development*, Introduction Section, http://www.esdtoolkit.org/discussion/default.htm (accessed: 10th August, 2014).

- Use of proper fertilizers and pesticides

- Familiarity with the banking culture

The above lines clearly indicate the importance of education for the development of agricultural sector, both in crop and non crop activities. The literacy rate can be increased through the allocation of a specific portion for education in agricultural credit for farmers and his children. The financial institutions are not supposed only to relate the amount of advanced loan to a particular crop (as did by the State Bank of Pakistan and Zari Taraqiati Bank of Pakistan)[393] but they also have to advance a specific liquidity under the same title for education. This mechanism is very fruitful, if followed, particularly for local farming in rural parts of the country.

In Pakistan however, neither the government through the central bank, nor the financial institutions have taken serious measures for the enhancement of farmers' education. The financial institutions just advance loan for their profit maximization and fulfillment of compulsory prudential rules and regulations imposed by the State Bank of Pakistan. The lack of proper inculcation of education in agricultural credit, therefore, has caused augmentation in illiteracy rate. This is proved not only problematic for farmers but equally for financial institutions. The following lines may narrate the story of all these problems.

As majority of farmers are ignorant,[394] therefore, it makes hard for the financial institutions to deal and workout financial arrangements with illiterate farmers. Due to the lack of proper education, the farmers are unaware about the various agricultural specified loan schemes offered by the financial institutions. By some good fortune even if they get the required information, and secure the loan, they are not in a position to utilize such loan for the development of their

---

[393]For example the Zarai Taraqiati Bank Ltd. (ZTBL) advances Rs.9, 600/hectare for wheat, Rs.20, 600/hectare for sugarcane, Rs.10, 300 /hectare for rice, Rs. 18,200/hectare for potatoes,Rs.23,000/hectare for Tobacco etc(Zarai Taraqaiti Bank Limited (Pakistan) , http://www.ztbl.com.pk/ (accessed July 20, 2014). The State Bank of Pakistan has developed the following scale for the provision of loan per hectare (The State Bank of Pakistan; http://www.sbp.org.pk/acd/appendex-I.pdf(accessed: 22nd July 2014).

[394]Mohsin Ali, *Agriculture Problems in Pakistan and Their Solutions*, March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013).

agricultural output, both in crop and non crop activities. It has happened many times that a farmer received an agricultural loan and then spent the same in some indispensable social activities i.e. marriages, education of their children, daily home expenditures, health activities etc. It is also happened that the entire secured loan gets paid against the debt received in past. This situation changes the condition of a farmer from bad to worse. The role of education can, therefore, not be over emphasized for farmers.[395] Illiteracy creates other problems too. For example, the educated farmers can get various information related to agricultural finance and verify the same through sources like mobile phones, personal connections etc while the illiterate are not so quick and depend on information from relatives.[396] In addition, the illiterate farmers are neither in a position to know properly about the use of modern agro technology in various agricultural activities nor the sort of fertilizers that can be used for a particular type of soil. They do not know how the best quality seed can be recognized and how the same could be used for the increase of agricultural yields.

In additional to those complexities, the conventional financial institutions have extremely complicated offerings which are difficult to comprehend even by an educated customer. It is rightly stated by Ricardo Sanchez Serrano that financial institutions become very complex and sophisticated in nature as they are offering very complicated products. Moreover, this complicacy is not limited only to the products, but also extended to the way of their investment resources, design, promotion and implementation of credit facilities.[397] Due to the lack of basic education and know how, the farmers are not in position to comprehend the individual/institutions' rights and obligations mentioned in their contract with the Islamic banks, Islamic financial institutions and conventional banks. Due to this reason, they sometime violate a contractual obligation or obligations and thus breach the contract without any bad intention. Some researchers establish with solid evidences that majority of farmers in developing countries

---

[395]Muhammad Asif Naveed, Mumtaz A. Anwar, Surraya Bano, *Information Seeking by Pakistani Farmers: A Review of Published Research*, Pakistan Journal of Library & Information Science, 13 (2012),p.5, http:// pu.edu.pk/images/journal/pjlis/pdf/pjlis-13-naveed.pdf(accessed: 21th March , 2014).

[396]Muhammad Zakria Zakar1, Rubeena Zakar,*Diffusion of Information Technology for Agricultural Development in the Rural Punjab: Challenges and Opportunities*,Pakistan Vision, vol.9 no.2,p.169.

[397]Ricardo Sánchez Serrano, *Ethical Issues Facing the Banking Industry*, Fidelis International Institute, January, 2010, https:// www.fidelisinstitute.org/article.php?se=13&ca=22(accessed: 20th March, 2014).

have little education and little knowledge of how modern banking institutions work. According to a report presented by the Committee on Customer Services in Banks (constituted by The Reserve Bank of India), the illiterate customers are not in position to use the ATM cards properly and hence the financial institution needed to issue Biometric ATM cards.[399] Therefore, if an illiterate customer faced failure to use his ATM card properly then how it would be possible for him to understand the complex mechanism of agriculture finance. It is because of all these reasons, the financial institution feel reluctant (may be rightly) to finance farmers, majority of whom are illiterate.

4.2.4 No Impact on the Reduction of Inherited Agricultural Risks:

The agricultural credit is mainly provided by the financial institutions to fulfill requirements of a farmer both for crop and non crop activities. However, this can not be considered the sole purpose, and the agricultural credit can be provided for non agricultural activities, particularly those which have a direct influence on agricultural production. Among these, the most important is the risk minimization techniques in agriculture sector. In Pakistan there is no concept of advancing loan for such purposes and the financial institutions are facing failure in this aspect too. Before the discussion related to the role of agricultural credit in risk mitigation, it is pertinent to discuss the kinds of risks faced by the farming sector in Pakistan

The history of agricultural finance reveals that financial institutions were initially hesitant to finance agricultural sector both for crop and non crop activities. There are numerous reasons responsible for this reluctance. The most significant among these is owing to the natural risks i.e. droughts, floods, hail storms, earthquakes, mudslides and multitude of other mishaps that the sector was susceptible to.[400] Pakistan has faced many natural disasters in the last few decades, and is exposed to human and economic loss. The following table sums it up.

---

[398]Renate K Loeppinger-T Odd And Manohar Sharma,*Innovations In Rural and Agriculture Finance*, J uly 2010The International Food Policy Research Institute (IFPRI).

[399]*Committee on Customer Service in Banks*,Reserve Bank of India,http://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=645(accessed: 20th March, 2014).

[400] Muhamoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50 http://farsi.ses.ac.ir/files/takmili/islamic_econ./capital_market/39.pdf (accessed May 16 ,2011).

Overview

No of events:	138
Number of people killed:	87,053
Average killed per year:	2,808
Number of people affected:	58,098,719
Average affected per year:	1,874,152
Economic Damage (US$ X 1,000):	18,402,814
Economic Damage per year (US$ X 1,000):	593,639

Table 8: Overview

Source: Pakistan - Disaster Statistics, Prevention Web, (UNISDR), https://www.preventionweb.net/english/countries/statistics/?cid=129 (accessed: 9th April 2014)

Andrew Dillon, Valerie Mueller and Sheu Salau, while referring to report of IPCC (Intergovernmental Panel on Climate Change), identify the occurrence of natural disasters, temperature fluctuations and the increasing rainfall variance as major disasters for agriculture sector particularly local faming.[401] These risks are unusual in the sense that they are not within the control of human being and hence cannot be eliminated. The other natural mishaps like pest attacks, however, can be controlled. For all such disasters, the governments have the responsibility to set up special Agricultural Disaster Management cells and manage the damage control. It may be useful to bill some funds in the annual budget to financially help out farmers who are left affected by misfortune natural disaster. The financial institutions should be advised to extend the period for repayment on case to case basis. In addition, the government must train

[401]Andrew Dillon,Valerie Mueller,Sheu Salau, *Migratory Responses to Agricultural Risk in Northern Nigeria*, IFPRI Discussion Paper 01007,July 2010, International Food Policy Research Institute, http:// www.ifpri.org/sites/default/files/publications/ifpridp01007.pdf(accessed: 16th February , 2014).

farmers particularly of those areas which are more exposed to a natural mishap/mishaps possibility on relevant coping mechanism.

The natural mishaps not only damage agricultural production but also decrease farmers' annual income. These circumstances incapacitate farmers to repay the amount given to them by financial institutions and thus become defaulters. They are neither in position to purchase assorted agricultural inputs for the next season nor can apply for the advancement of new loan facility to any financial institution.

Due to the above mentioned reasons, before embarking on the provision of financing facility, the financial institutions and even the informal sources i.e. relatives, neighbor, friends find it difficult to release finance for agriculture.

Besides the natural risk, there are some other un-natural risks faced by agriculture sector. These risks include economic risks, operational risks, social risks, political risks etc.[402] The economic risks include price fluctuations, fall in demand, interest rates, exchange rate etc. These risks are controllable if the governments play due role and bring economic stability in their regions. The operational risks relate to land (e.g. soil contamination), capital (e.g. depreciation), labour (e.g. illness) etc. These risks can also be controlled by the governments through institutional efforts. The social risks ensue from social behaviors including strikes, theft, riots, warfare etc. All these risks can be controlled or curtailed through strong economic, political, and social policies. In the view of experts, financing is viable for all stakeholders (i.e. Islamic banks, Islamic financial institutions, conventional banks, conventional financial institutions and farmers) if these risks are properly managed and controlled. These include forming mutually beneficial partnerships (in which benefits and risks are shared), aggregation of clients (such as price risk management and insurance), good banking practices (carried out in the best interest of the agriculture sector and farmers), government policy and interventions (for the growth and development of agricultural finance and insurance services), well designed and qualified technical assistance (increasing understanding and awareness among farmers regarding the importance of financial services), insurance (bringing more insurance products and services in

[402]Matthias Bickel, Martin Klein,*Rethinking Rural and Agricultural Finance* –The African Case, international Platform, , https:// www.rural21.com/.../R21_Rethinking_rural_and_agricultural_finance_0... (accessed: 17th March, 2014).

the market to promote agricultural finance at all levels), innovations in agriculture finance (developing new products for financing agriculture, and improving the existing ones), price risk management, innovative forms of collaterals and collateral substitutes (as majority of farmer belong to the lower class and hence not in position to furnish required collaterals conditioned by the financial institutions for the provision of loan facility), financial literacy (improving risk management in agricultural finance), leasing techniques (as they do not require collaterals and credit history of the applicant etc), certification etc.[403]

Keeping in view the inherited risks of agriculture, particularly those which are natural, the State Bank of Pakistan has asked all the financial institutions (Islamic banks, Islamic financial institutions, conventional banks, conventional banks' Islamic windows, specialized agriculture banks) to grant relaxation to farmers in repayment schedule for a period up to one year at the time of some natural mishaps like inclement weather, drought, earthquake, mudslide, storms, flood etc. The following statement of the State Bank, given in its guideline for financing agriculture, evidences the same,

> "The banks/DFIs are allowed to grant relaxation up to one year in repayment schedule, to their borrowers who have been adversely affected due to certain unforeseen and unexpected factors like weather, availability of water, etc. which are not under the control of the farmers. Such relaxation may be granted on case-to-case basis or en-block to the borrowers in the affected area"[404]

In addition, the banks are also advised, in the same guideline, to provide helpful measures to farmers at the time of such natural mishaps. The banks are encouraged to stop recovery from the farmers in such a critical situation, or even waive up the principle amount when the recovery is not possible because of critical factors. The nature of relaxation may vary from place to place, time to time and individual to individual, depending upon the circumstantial situation,

---

[403]The official website of world Bank can be visited for detailed discussion of the issue…………….. Expert Meeting on Managing Financing Risk in Agriculture, Agricultural and Rural Development, The world Bank, https:// web.worldbank.org › Topics › Agriculture & Rural . (accessed: 17th March, 2014).

[404]*Prudential Regulations for Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

discretionary power of the financial institutions and their inner agricultural finance policies. All these relaxations are made owing to the fact that all these catastrophes are not within the control of the human beings. This approach of the State Bank of Pakistan is in line with the commandments of the Holy *Qur'ān* whereby the creditor is advised to provide relaxation to the debtor till the time of ease, and if even then he is not in a position to repay, to remit the whole amount.[405]

No doubt that advising relaxation in term of repayment is a very a good initiative taken by the State Bank of Pakistan to help out farmers of catastrophically effected areas, however, some other best efforts can also be made to deal with the situations in a better way. The central banks can make it mandatory for all financial institutions in the country, to allocate a pre determined amount in their over all agricultural credit funds in order to help out farmers at the occurrence of natural and unnatural mishaps. The government can also contribute in these funds either through the central bank or through the National Disaster Management Authority (NDMA). A special priority must be given, however, in these funds to natural mishaps like floods, hailstorm, earth-quake, mud sliding etc.

4.2.5 No Satisfactory Increase in Agricultural Production

The main purpose of advancing agricultural loan is to increase the rate of production and consequently, overcome the shortage of food. The financial institution usually provide loan just to facilitate farmers and earn profit without having any regard for the rate of production. Many researchers, therefore, have a view that institutional credit does not have any affect on the out put directly.[406] Owing to this fact, many commercial banks provide loan to farmers without going for practical supervision of their credit; which is very necessary for the quality use of credit. The loan, therefore, is used by farmers for some non agricultural purposes i.e. medical treatment, marriages, business, construction of house, utility bills etc.[407] This badly effects the production

---

[405]*Qur'ān* says "And if any debtor be in straitened circumstances, and then grant him respite till a time of ease. And that you remit it as charity shall be better for you, if only you knew" (Al. Qurān 2:281).

[406]Muhammad Iqbal, Munir Ahmad, Kalbe Abbas ,*The Impact of Institutional Credit on Agricultural Production in Pakistan* ,The Pakistan Development Review, vol. 42, no. 4, Papers and Proceedings PART II Nineteenth Annual General Meeting and Conference of the Pakistan Society of Development Economists Islamabad, January 13-15, 2004 (Winter 2003), pp. 469-485, Pakistan Institute of Development Economics, Islamabad.

[407]Aamir Riaz, Ghazanfar Ali Khan,Munir Ahmad, *Utilization of Agriculture Credit by the Farming Community of Zarai Tariqiati Bank Limited (Ztbl) For Agriculture Development*, Pak. J. Agri. Sci., vol. 49(4).

rate to a great extent as the farmers do not feel any pressure of being supervised by the financial institutions nor for any penalty in case of violation. Being responsible for the development of agriculture sector, the State Bank of Pakistan has taken some concrete measures for the supervision of agricultural credit. In this connection, the Supervised Agricultural Credit Scheme has been introduced asking the commercial banks to supply all essential inputs and technical guidance on farm management in addition to supervision of end use of finance. [408] However, the financial institutions have followed theses instruction to the extent of documentations, without going for the practical supervision of the advanced liquidity. By this negligent approach of commercial banks, one can hardly think about the affect of such loan on the rate production per hectare. As a result, the farmers' income has remained constant and in some worst has faced decline. The lack of proper increase in income has increased the number of defaulters and consequently the financial institutions, latter on, have left their agricultural loan schemes; pretending one reason or another.

Some of the financial institutions, on the other hand, have followed instruction of the State Bank, both in letter and spirit, and inculcated credit supervision mechanism in their agricultural credit policies. By doing so, they have brought a drastic change in farmers production rate. The Zarai Tariqiati Bank Limited (ZTBL), an agricultural specialized bank, is a typical example in this connection. Naushad Khan, Inayatullah Jan, Mujib ur Rehman Anwar Mehmood and Akhtar Ali have proved empirically this fact in their research with minute details.[409] The recent annual report (ZTBL's 2012 Annual Report) of the bank, ratifies the same achievement by stating

> "The Bank has been playing an instrumental and proactive role in modernization of agriculture, boosting productivity and enabling growers, particularly the landless poor and small landowners to increase their farm productivity and income. ZTBL alone serves about 0.4 million farm families annually and shares around 22% of the total institutional credit. The concept of

---

[408] Agricultural credit Department, State Bank of Pakistan , http://www.sbp.org.pk/acd/Events/BROCHURE.pd(accessed: 12th August, 2014).

[409]Naushad Khan, Inayatullah Jan,Mujib ur Rehman Anwar Mehmood ,Akhtar Alim,*The Effects of Short Term Agricultural Loans Scheme of Zarai Tarraqiati Bank on Increase in Farm Production In District Karak* , Sarhad J. Agric. vol. 23, no. 4, 2007.

Supervised Credit Scheme(SCS) through Mobile Credit Officer (MCOs) had been highly appreciated by the World Bank and other international financial institutions and ZTBL is progressing and achieving its national goal through this scheme."[410]

The Statement clearly indicates the zeal of the bank for the development of agricultural sector as a whole with a specific emphasis on the production rate.[411] It is a surprising and appreciable step that the bank has disbursed a major portion of its loan for production purpose rather than development. The following graphical presentation can be presented as solid evidence in this regard.

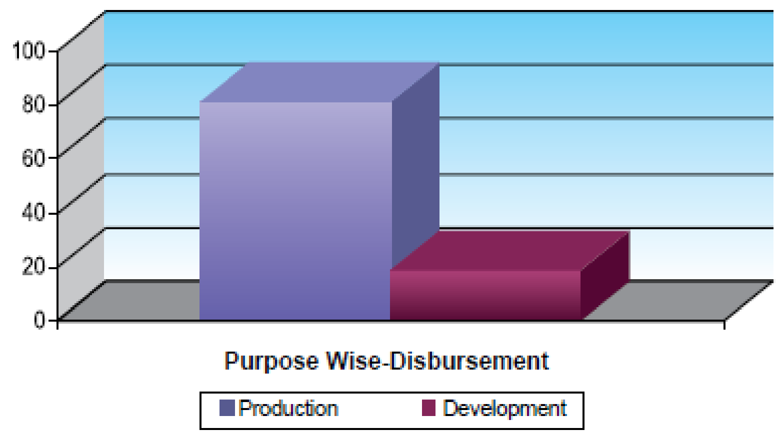


Figure 3: Purpose wise disbursement

Source: Annual Report 2012, the Zari Taraqiati Bank of Pakistan, p.33

---

[410]Zarai Taraqaiti Bank Limited (Pakistan), *Annual Report,2012* ,pp31-32 , http://www.ztbl.com.pk/ (accessed August 12th, 2014).

[411]The role of ZTBL and its success in agriculture sector, particularly in local farming, can be evidenced from the fact that a substantial growth has been witnessed in the last few years in production rate. For example, the annual report of 2012 shows that production of major crops is increased tremendously. The production of Cotton is raised by 18.6 percent, Sugarcane 4.9 percent and Rice by 2.4 percent. Although the bank has disbursed less amount (Rs.64, 133 million) in 2012 as compared to2011 (where Rs.65, 452 million has been disbursed). The secret behind this success is the determination of the bank for the development of agricultural sector both for crop and non crop activities ,as prescribed in its mission statement……….Zarai Taraqaiti Bank Limited (Pakistan), Annual Report, 2012,p.32 , http://www.ztbl.com.pk/ (accessed August 12th, 2014).

According to the study, conducted by Muhammad Khalid Bashir, Yasir Mehmood, and Sarfraz Hassan, the United Bank Limited (UBL), a leading commercial bank in Pakistan, has also achieved the same results through their agricultural credit.[412] However, this success is achieved only in wheat production and should be extended to other crops with the same zeal and experience. The following table can be resorted for further information about the same success.

Area, Production and yield of wheat

Year	Area		Production		Yield	
	(000 hectares)	% Change	(000 tons)	(Kg/Ha.)	(Kg/Ha.)	% Change
2004-05	8358	1.7	21612	10.8	2586	8.9
2005-06	8448	1.1	21277	-1.6	2519	-1.9
2006-07	8548	1.0	23295	9.5	2716	7.8
2007-08	8550	-0.3	20959	-10.0	2451	-9.8
2008-09 (P)	9062	5.9	23421	11.7	2585	5.5

P = Provisional; Source: GOP, 2009.

Table 9: Area, production and yield of wheat

Source: Muhammad Khalid Bashir,Yasir Mehmood, Sarfraz Hassan ,Impact of Agricultural Credit on Productivity of Wheat Crop: Evidence from Lahore, Punjab, Pakistan, Pak. J. Agri. Sci., Vol. 47(4), 405 409; 2010 ISSN (Print) 0552-9034, ISSN (Online) 2076-0906 http://www.pakjas.com.pk (accessed 13th August, 2013)

However, these few examples do not mean under any stretch of explanation that agricultural credit has been used properly by farmers for a better increase in production. Due to increase in population in Pakistan, demand for food is drastically increased; and if not handled properly, the situation may become worst in the nearest future. This situation is not limited to Pakistan only as half of the world population has been affected by food deficiency.[413] Similarly, in the modern times agricultural products are used in a variety of food products which has further increased demand for food. Now wheat ,which is one of the top three crops grown all over the world, is not only used for local bread but is rather a source of many products i.e. flour, baked goods, pasta, pizza, cereals, canned soups, sauces, dip and gravy mixes, instant drinks, deserts, ketchup,

---

[412]Muhammad Khalid Bashir,Yasir Mehmood,,Sarfraz Hassan ,*Impact of Agricultural Credit on Productivity of Wheat Crop: Evidence from Lahore, Punjab, Pakistan*, Pak. J. Agri. Sci., vol. 47(4), pp.405 -409.

[413]Eric Holt-Gim nez,*The World Food Crisis: What is Behind it And What We Can Do*, http://www.worldhunger.org/articles/09/editorials/holt-gimenez.htm(accessed July 30, 2013).

sweets and etc.[414] Likewise rice is not only cooked at local level but is now excessively used in a number of products like rice cake, baby cereals, rice gruel, rice noodles, kaset rice etc. Because of this reason, demand for these basic agricultural products has increased rapidly in the last half of the 20th century. Another reason for the food shortage is the distribution of land through the law of inheritance particularly in Islamic countries where the Islamic law of inheritance is applied. The reason is that by inheritance the land is cut down into small pieces and this affects its productivity to a great extent. Some of the scholars like Paul Francis, share the same view by stating,"The division of land upon inheritance leads to holdings becoming uneconomic in size and productivity"[415]

While keeping in view the demand for food, the State Bank of Pakistan has taken some solid steps to facilitate the growth in agricultural production.[416] In this regard, the central bank has set agricultural credit disbursement target of Rs. 500 billion for 2014-15. This allocation of huge amount clearly indicates positive intention of the State Bank for the enhancement of agricultural production on one hand and its anticipation regarding the food shortage on the other hand. This huge amount, however, if used properly, can bring a very substantive increase in production. It is rightly said by Aamir Riaz, Ghazanfar Ali Khan, and Munir Ahmad in their scholarly work

> "The capital is considered as one of the basic essentials for boosting vital sector of agriculture. It plays an important role in agricultural development because timely availability of capital leads to adoption of improved seed, fertilizer and modern technologies, which increase the farm production and ultimately the

---

[414] Twenty (20) Common Foods Containing Wheat, http://www.3fatchicks.com/20-common-foods-containing-wheat/(accessed: 2nd April 2014.

[415] Paul Francis,Humid Zone Programme ILCA, P.M.B. 5320, Ibadan, Nigeria, No. 24–March 1986. http://, www.ilri.org/InfoServ/Webpub/fulldocs/Bulletin24/Land.htm(accessed: 30th March, 2014).

[416] SBP sets Agriculture Credit Disbursement t arget of Rs 500 billion for 2014-15,July 12, 2014, State Bank of Pakistan,http://www.sbp.org.pk/press/2014/ACAC-12-Jul-14.pdf(accessed: 13th August, 2014).

growth rate. Therefore, agriculture credit is an important element for modernization in agriculture and uplifting Pakistan's economy."[417]

4.2.4 Remoteness from Financial Institutions

As mentioned above, a majority of farmers in developing countries reside in rural areas. For instance, in case of Pakistan 62% of the country's population live in the rural areas and is directly or indirectly allied with agriculture as its livelihood.[418] It confirms that Pakistani agriculture is predominantly rural.[419] The case of Bangladesh is similar whereby 80% of its population constitute rural.[420] An empirical research showed the same for the state of Ghana.[421] Renate K Loeppinger-T Odd and Manohar Sharma stated that numerous agricultural households are so widely dispersed is different parts of the country that financial institutions find it challenging to offer inexpensive and cost-effective services.[422]

This dispersal also limits financial institutions ability to get in touch with such farmers. They open very few branches in rural areas as they often turn out to be non profitable, owing to dispersed populations, poor road and energy infrastructure, type of clientele, as well as their portfolio.[423] As a result, farmers secure loan from informal sources i.e. relatives and friends, rural

---

[417] Aamir Riaz, Ghazanfar Ali Khan,Munir Ahmad, *Utilization of Agriculture Credit by the Farming Community of Zarai Tariqiati Bank Limited (Ztbl) for Agriculture Development*, Pak. J. Agri. Sci., vol. 49(4), pp. 557-560; 2012 ISSN (Print) 0552-9034.

[418] Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan Ministry of Finance, Chapt.2,p.13 http://www.finance.gov.pk/(accessed January,2013).

[419] Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan*, The Pakistan Development Review, vol. 38, no. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of DevelopmentEconomists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716.

[420] *Strengthening Agricultural Support Services for Small Farmers*, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

[421] William F. Steel,David O. Andah, *Rural and Micro Finance Regulation in Ghana: Implications for Development and Performance of the Industry*, Africa Region Working Paper Series No.49 June 2003, http://www.worldbank.org/afr/wps/index.htm. (accessed Deceber 25, 2012).

[422] Renate K Loeppinger-T Odd And Manohar Sharma,*Innovations In Rural and Agriculture Finance*, J uly 2010The International Food Policy Research Institute (IFPRI).

[423] Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, *Creating Access to Agricultural Finance Based on a Horizontal study of Cambodia, Mali, Senegal, Tanzania,Thailand and Tunisia*, July 2012,p.24,capacity4dev.ec.europa.eu/.../creating_access_to_agricultural_finance.*pd*(accessed July 16, 2013).

traders, moneylenders and landlords etc. The loans offered by the relatives and friends are usually interest free but involve small amounts and hence not sufficient to fulfill a farmer's need. The loans on the other hand, provided by rural traders, moneylenders and landlords etc charge high interest rate. They used to earn monopoly profit from the farmers and the latter had no choice other than acceptance.[424] A Study empirically established that a substantive fraction of such loans had to be used in activities other than agricultural i.e. food, medical expenses, marriage/death or other ceremonial expenses, purchase or improvement of family dwelling, to pay off old loans etc.[425] The improper use of such loans compelled some of the farmers to live in a everlasting debt.

The state Bank of Pakistan, while providing guideline for rural agricultural financing, pointed out the same issue by stating:

> "In developing countries and transitional economies, only a very few rural masses have access to financial services. Rural areas are often characterized by a paucity of viable financial institutions and lack of variety of financial services available. Rural communities often do not have access to saving options, credit services, insurance, or transaction services"[426]

While reacting to the situation, the central bank brought some drastic changes in the existing body of rules and regulations to create an environment where the Islamic banks, Islamic financial institutions and conventional financial institutions would put greater emphasis on financing agriculture. Such changes included the following major steps:[427]

a) The central bank allowed banks to adopt the concept of branchless banking and create sub branches, special booths and services centers, particularly in rural areas

---

[424] Walter Schaefer – Kehnert and Jhon D.Von Piodike "*Agricultural Credit Policy In Developing Countries*", World Bank Re Print Series: Number 280, 1982.p.4.

[425]Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab*, European Journal of Scientific Research, Vol.23, no.2 (2008), pp.294-304.

[426]*Handbook on Best Practices in Agri/Rural Finance*, Agricultural Credit Department, State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

[427] Ibid, pp.7-8

of the country. It was intentionally done for the purpose to minimize the transaction costs.

b) In order to enhance the number of branches in rural areas, the State Bank of Pakistan made it mandatory for all banks (including conventional and Islamic) to open at least 20% of new branches in rural areas of the country. Due to these dynamic policies, the NBP (National Bank of Pakistan) launch 40 new branches in the rural areas.[428] The Indian Central Bank had taken the same measures excessively during the period of 1977 and 1990.[429]

c) To facilitate the farmers, the central bank also released district wise data of agricultural credit including the data of rural districts.

d) Special training programs were arranged in order to create awareness in farmers (both in rural and urban) and commercial bankers. Such step paved a way for the creation of an environment where all stake holders (farmers and bankers) of agricultural finance started understanding each other.

e) An Agricultural Credit Department was established to represent the State Bank of Pakistan in agriculture, rural finance, its policies and various projects. This was done to update all Islamic banks, Islamic financial institutions, conventional banks and conventional financial institutions regarding the new dimensions settled by the central bank from time to time.

---

[428]Imaduddin, *NBP To Open 40 New Branches in Rural Areas,* Wednesday, 13 March 2013 03:26, Business Recorder,www.brecorder.com › Pakistan › Banking & Finance(accessed: 23th March, 2014).

[429]During the period of 1977 and 1990, the Indian Central Bank made it mandatory by stating that only those commercial banks could open a branch in a location one or more bank branches which had opened four branches in that location where no other banks had opened any branch. Due to the rule, many commercial banks opened their branches (approximately 30,000 branches) in rural areas for the provision of financial services……….. Robin Burgess, Rohini Pande, *Do Rural Banks Matter?Evidence from the Indian Social Banking Experiment,* Discussion PaperNo. DEDPS/40, August 2003, The Suntory Centre, Suntory and Toyota International Centre for Economic and Related Disciplines, London School of Economics and Political Science,http:// eprints.lse.ac.uk/.../Do_Rural_Banks_Matter_Evidence_from_the_Indian. (accessed: 23th March, 2014).

Similar was the case of some other developing countries where farmers of rural areas had no access to any kind of financial services.[430] However, due to the active involvement of concerned governments and their central banks, the financial institutions were compelled in various ways, like through incentives, registration requirements, policy issues, rules and regulations, appraisals, etc to extend their business in rural parts of the country. A tremendous achievement was made by the Indian Central Bank in this connection.[431]

4.3 Conclusion

The main purpose of formal agricultural finance is to develop agricultural sector both for crop and non crop activities, and consequently put positive impact on the economic health of farmers. These goals can be achieved if rules and regulations that govern agricultural financing are flexible in nature and up to the task. In this regard, the laws related to the procedure in agriculture finance, the legal requirements for the disbursement of agriculture loan, the nature of required collaterals, rules and regulations for the supervision of farmers' use of agricultural credit, laws for the recovery of loans, criteria and bench mark for the determination of interest rates etc must be settled in such a way that facilitates farmers in getting agricultural credit in the easiest possible manner. However, critical analysis of existing agricultural financing mechanism in Pakistan shows that a very complicated financing system has been introduced in the country for the last two decades. Therefore, the financial institutions face failure to achieve the intended goals from agricultural credit. There are many reasons for this failure. Firstly, the financial institutions follow a very rigid procedure for the advancement of loan facility; comprises of many steps, and takes excessive time for its completion. In case of agricultural loans, procedures become more rigid because of the inherited risks involved in this sector. Secondly, these

---

[430]Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, *Creating Access to Agricultural Finance Based on a Horizontal Study of Cambodia, Mali, Senegal, Tanzania,Thailand and Tunisia*, July 2012,pp.5-6,capacity4dev.ec.europa.eu/.../creating_access_to_agricultural_finance.*pd*(accessed July 16, 2013).

[431]Robin Burgess, Rohini Pande, *Do Rural Banks Matter? Evidence from the Indian Social Banking Experiment*,Discussion PaperNo. DEDPS/40, August 2003, The Suntory Centre, Suntory and Toyota International Centre for Economic and Related Disciplines, London School of Economics and Political Science,http:// eprints.lse.ac.uk/.../Do_Rural_Banks_Matter_Evidence_from_the_Indian. (accessed: 23th March, 2014).

institutions do not provide a single penny without fitting collaterals and other securities. These securities are normally of higher value than loans advanced, since they cannot otherwise serve the intended objectives i.e. protection of loan. Thirdly, there is lack of proper legal mechanism for the recovery of loan advanced. The general procedure of law for the recovery of loan if followed, the amount on litigation sometime crosses the amount due. Therefore, the financial institutions opt other sectors for financing rather than agriculture. Fourthly, the financial institutions usually follow superfluous legal documentation process for agricultural credit as compared to the documentation they require in their normal financing activities. A critical analysis of all the required documents reveals that many of such documents are not required for the credit worthiness of a farmer. Fifthly, the most critical aspect of agricultural finance in Pakistan which is very much criticized by the expert is the rate of interest charged by the commercial banks and other financial institutions. Each and every financial institution charges interest rate according to its own self-made rules and regulations which are directly or indirectly revolve around the philosophy of profit maximization. Due to these reasons, failure starts in various aspects of farmers' life, both agricultural and non agricultural. This leads to a situation where there is no positive and dynamic augmentation in agricultural production, replacement of old and weak farming practices with new one, increase of literacy rate in farmers in their offspring, positive change in their living standards, increase in income to such extent that they may not ask for further credit, poverty reduction, increase in tax revenues, increase in export etc.

CHAPTER 5

DEVELOPMENT OF SHARĪ'AH'S BASED MODELS FOR FINANCING AGRICULTURE (WITH A SPECIAL REFERENCE TO PAKISTAN)

5.1 Introduction:

Being a complete code of life, Islam offers wide-ranging guidance for humans in all facets of life. This characteristic has been discussed by the Holy *Qur'ān* in many of its verses.[432] But the comprehensive guideline does not mean that each and every aspect has been discussed with microscopic details, rather a basic doctrine is provided from which an exhaustive set of principles can be derived by the competent authorities through the way of *Ijihād.*[433] Agriculture, as an important aspect of human life, has also been dealt with by this universal system (Islamic law) in an identical way. There are many *Aayāt* (verses) in the Holy *Qur'ān* that discuss agriculture from various angles.[434] All these verses are plentiful in number, showing the

---

[432]"There is not an animal (That lives) on the earth, Nor a being that flies On its wings, but (forms Part of) communities like you. Nothing have we omitted From the Book, and they (all) Shall be gathered to their Lord In the en". *(Qur'ān 6:38)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 15 July2012);One day We shall raise From all Peoples a witness Against them, from amongst themselves: And We shall bring thee As a witness against these (Thy people): and We have sent down To thee the Book explaining All things, a Guide, a Mercy, And Glad Tidings to Muslims". *(Qur'ān 16:89)*translated by Abdullah Yūsuf Alī), (1872–1953);http://www.quran4u.com/quran_english_Yeh.htm(accessed: 15 July2012).

[433] The meaning of *Ijihād.*is to strive with one's ability to derive the divine laws from the *Qurān* and *Sunnah* of the Holy Prophet(SM).This derivation should be done by a person having capacity for *Ijihād,* described by the classical Muslim jurists. The derivation of rules without having the capacity for *Ijihād.*, has been prohibited in *Sharī`ah* (Islamic Law). See for further details……Imam Abū Zahrah, *Usūl al Fiqh*, Dārul Fikru al Arabi, p.379

[434]Behold! In the creation Of the heavens and the earth; In the alternation Of the Night and the Day; In the sailing of the ships Through the Ocean For the profit of mankind; In the rain which God Sends down from the skies, And the life which He gives therewith To an earth that is dead; In the beasts of all kinds That He scatters Through the earth; In the change of the winds, And the clouds which they Trail like their slaves Between the sky and the earth;— (Here) indeed are Signs For a people that are wise. (*Qur'ān 2:64)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013); And God sends down rain From the skies, and gives therewith Life to the earth after its death: Verily in this is a Sign For those who listen. *(Qur'ān 16:65)* translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);A Sign for them Is the earth that is dead: We do give it life, And produce grain there from, Of which ye do eat. And We produce therein Orchards with

importance of agriculture for human beings. The believers are invited to take benefit from what has been created by the Lord (Allah SWT) in this earth; through the process of cultivation, plantation etc. Like is the case of *Hadith* (traditions) of the Holy Prophet (SAW).[435] However,

---

date-palms And vines, and We cause Springs to gush forth therein: *(Qur'ān 36:33,34)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);Who has made the earth your couch, And the heavens your canopy; And sent down rain from the heavens; And brought forth therewith Fruits for your sustenance; Then set not up rivals unto God When ye know (the truth). *(Qur'ān 2:22)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);It is He Who sends down Rain from the sky: From it ye drink, And out of it (grows) The vegetation on which Ye feed your cattle With it He produces For you corn, olives, Date-palms, grapes, And every kind of fruit: Verily in this is a Sign For those who give thought*(Qur'ān 16:10,11)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);And who bringeth out The (green and luscious) pasture, And then doth make it (But) swarthy stubble*. (Qur'ān 137:4, 5)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);And cattle He has created For you (men): from them Ye derive warmth, And numerous benefits, And of their (meat) ye eat. And ye have a sense Of pride and beauty in them As ye drive them home In the evening, and as ye Lead them forth to pasture In the morning. And they carry your heavy loads To lands that ye could not (Otherwise) reach except with Souls distressed: for your Lord Is indeed Most Kind, Most MercifulAnd (He has created) horses, Mules, and donkeys, for you To ride and use for show; And He has created (other) things Of which ye have no knowledge. *(Qur'ān 16:5-8)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);See they not that it is We Who have created For them—among the things Which our hands have fashioned— Cattle, which are under Their dominion? —And that We have Subjected them to their (use)? Of them some do carry them And some they eat: And they have (other) profits From them (besides), and they Get (milk) to drink. Will they not then Be grateful? *(Qur'ān 36:71-72)*translated by Abdullah Yūsuf Alī), (1872–1953); http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013);Eat (for yourselves) and pasture Your cattle: verily, in this Are Signs for men Endued with understanding.*(Qur'ān 20:54)*translated by Abdullah Yūsuf Alī), (1872–1953);http://www.quran4u.com/quran_english_Yeh.htm(accessed: 22 December2013).

[435]*Narrated Abu Umama al-Bahili:*I saw some agricultural equipments and said: "I heard the Prophet saying: "There is no house in which these equipment enters except that Allah will cause humiliation to enter it."(Bukh*ā*rī; Hadith No. 514); *Narrated Anas bin Malik:*Allah's Apostle said, "There is none amongst the Muslims who plants a tree or sows seeds, and then a bird, or a person or an animal eats from it, but is regarded as a charitable gift for him." (Bukh*ā*rī; Hadith No. 513); *Narrated Abu Huraira:Allah'*s Apostle said, "Whoever keeps a dog, one Qirat of the reward of his good deeds is deducted daily, unless the dog is used for guarding a farm or cattle." Abu Huraira (in another narration) said from the Prophet, "unless it is used for guarding sheep or farms, or for dog for guarding cattle or for hunting." (Bukh*ā*rī; Hadith No. 515); *Narrated 'Abdullah bin 'Umar:*The Prophet concluded a contract with the people of Khaibar to utilize the land on the condition that half the products of fruits or vegetation would be their share. The Prophet used to give his wives one hundred Wasqs each, eighty Wasqs of dates and twenty Wasqs of barley. (When 'Umar became the Caliph) he gave the wives of the Prophet the option of either having the land and water as their shares, or carrying on the previous practice. Some of them chose the land and some chose the Wasqs, and 'Aisha chose the land. (Bukh*ā*rī; Hadith No. 521); *Narrated 'Amr:*I said to Tawus, "I wish you would give up Mukhabara (Share-cropping), for the people say that the Prophet forbade it." On that Tawus replied, "O 'Amr! I give the land to share-croppers and help them. No doubt; the most learned man, namely Ibn 'Abbas told me that the Prophet had not forbidden it but said, 'It is more beneficial for one to give his land free to one's brother than to charge him a fixed rental." (Bukh*ā*rī; Hadith No. 523); *Narrated Rafi:*We worked on farms more than anybody else

the concept of agricultural finance is neither discussed directly by the Holy *Qur'ān* and nor by the *Sunnah* of the Holy Prophet (SAW). This does not mean under any stretch of explanation that agricultural finance is *Harām* (prohibited), for not being affirmed *Halāl* (permissible) in the basic sources of *Sharī`ah* (Islamic Law).

5.2 Islamic Banks, their Aims and Purposes (a Special Reference to Agricultural Finance):

Before embarking on the legitimacy of Islamic agricultural finance and its application to the agricultural sector in Pakistan, it is appropriate to answer the question why Islamic banking is important and indispensable particularly in Islamic countries.

Islam gives a vital importance to trade. There are many verses of the Holy *Qur'ān* which are either directly related to the introduction of trading activities or related to their philosophies, aims and purposes, rules and regulations etc. The Hadiths of the Holy Prophet (SAW) have served the same purpose. A close study of these philosophies reveal that the Islamic economic system is established for an equal distribution of wealth and social justice, both of which cannot be achieved in a *Ribā* based economy.[436] The aims and purposes of an Islamic economic system require that all these trade activities are structured in such a way to serve the interest of society as a composite whole, keeping in view both the affluent and those in need of support. The Islamic banking system is structured for the accomplishment of those objectives as envisaged by *Sharī`ah* and, therefore, Islamic banking is defined in the same context. For instance, The State Bank of Pakistan defines Islamic banking in an official document as

> "(Islamic banking is a) banking in consonance with the ethos and value system of Islam. and governed, in addition to the conventional good governance and

---

in Medina. We used to rent the land and say to the owner, "The yield of this portion is for us and the yield of that portion is for you (as the rent)." One of those portions might yield something and the other might not. So, the Prophet forbade us to do so (Bukhārī; Hadith No. 525)… It is to be noted that all these Hadith are taken from the website after duly confirmed from the original text of Bukhārī in Hard form , existing in the personal library of the author ……http://sacred-texts.com/isl/bukhari/(accessed: 13th August, 2014).

[436]Mazhar Ali Bokhari, *Introduction to Islamic Banking*, 2010, AlHuda CIBE Awareness workshop B.Z University –Multan.Avialblea, http://www.alhudacibe.com.Presentations %20on%20Islamic%20Banking%20and%20Finance (accessed November 24, 2012).

risk management rules, by the principles laid down by Islamic *Sharī'ah*".[437]

The definition of Islamic banking mentioned in the Islamic Banking Act of Malaysia (section 2) is not much different from that of the State Bank of Pakistan when it states "Islamic bank, means any company which carries on Islamic banking business and holds a valid license…"[438] In the same section the Islamic banking business is defined as "Islamic banking business means banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam"

The discussion shows that Islamic banks have an important role to play their active role in the development and prosperity of the society. Unlike the conventional financial institutions which rely on profit maximization, the Islamic banks aim to introduce those services and products in the market which are viable and beneficial for society. They opt for such products and services even if the profit ratio in these is less than those of conventional financial institutions. As agriculture deals with less well-off farmers, the Islamic financial institutions should concentrate more on financing this sector with the same approach. Rather than looking only at the viability of this sector from an earning perspective; they should also aim for social welfare and support of the society. This social obligation of Islamic banks and other Islamic financial institutions have been pointed out by many reputed scholars in their work. Muhammad Taqi Usmani, a pioneer of Islamic banking in Pakistan, claims that the Islamic economy requires a basic change in the approach and outlook of financial institutions.[439] In the view of Sabir Mohamed Hassan, the Islamic bank is supposed to be a socially responsible institution (SRI) with social, cultural and other responsibilities besides profit making.[440] One amongst those is to help out the poor sector of the society including farmers, majority of whom belong to the less well-off. In the case of Pakistan, for instance, seventy four percent (74%) of the country's

---

[437]*Handbook of Islamic Banking Products & Services*, Islamic Banking Department, State Bank of Pakistan. http://www.sbp.org.pk/ibd/Handbook-IBD.pdf, (accessed November 24, 2012).

[438]Laws of Malaysia Act 276, Islamic Banking Act 1983,http://www.bnm.gov.my/documents/act/en_ib_act.pdf - Cached (accessed November 24, 2012).

[439]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, Editon August 2008, p.244

[440]Sabir Mohamed Hassan ,*Issues in the Regulation of Islamic Banking(The Case of Sudan)*, Issue no.5,2004 ,Research and Studies Series Issued by Bank of Sudan,http://www.cbos.gov.sd/sites/default/files/issue_5.pdf - Cached(accessed August 30th,2014).

farmers are small farmers.[441] The proposed *Sharī`ah* based models introduced in this research for financing agriculture, both for crop and non-crop activities are based on the same approach.

5.3 *Sharī`ah* Based Models for Financing Agriculture

As stated earlier that *Sharī`ah* is a complete code of life and, therefore, covers each aspect of human life; among which agriculture is the most important. For the smooth and rapid development of this sector, various rules and regulations have been prescribed by *Sharī`ah* through its basic sources i.e. the Holy *Qur'ān, Sunnah* of the Holy Prophet (SAW). Such set of rules and regulations have direct impact on the development of the agricultural sector by one way or another, and hence, very important to be studied profoundly and then applied effectively.

Islamic commercial law provides some basic methods for regulating various commercial activities, which usually take place in the market. All these methods are structured and designed in such a way to come up with some basic results, intended by Islamic law and include the following.

- Provision of opportunity for all concerned individuals to earn *Halāl* (permissible) income.
- Preventing the partners to earn *Harām* (prohibited) income by any means.
- Elimination of *Ribā* (interest) from all commercial activities.
- To promote equitable distribution of wealth in the society according to the work and intellect of an individual.
- To help out poorer segments of the society.

These golden objectives of Islamic commercial law can be fulfilled through various techniques, called Mushārakah (partnership),[442] *Murābahah* (sale with profit), *Ijārah* (leasing), *Salam* (advance payment sale), *Istisnā'* (manufacturing contract) *Diminishing Mushārakah,*[443]

---

[441]*Financing Scheme for Small Farmers* , Agricultural Credit Department Islamic Banking Department State Bank of Pakistan(accessed: 28th February , 2014).

[442] "It is a partnership which comes into being as a result of agreement between two or more persons in order to share profit"Commission of Ottoman Jurists (1867-1877), *Majallah al-Ahkām al-'Adliyah* (Constantinople, 1305 AH), Article 1329.

[443]It is a new form of partnership in Islamic law, developed by the present-day scholars in recent years. It merges a number of concepts of Islamic commercial law in its structure and compositions i.e. lease sale, partnership, agency contract and gift. It allows equity participation of Islamic bank and its customer in a commodity of any types,

Musāqah, *Muzāra`ah* (temporary sharecropping contract) etc. All these contracts are so general in nature (excluding *Musāqah* and *Muzāra* as both these transactions are specially designed for agriculture) that they can be easily applied for the development of any business activity. Having this peculiar character, all these commercial transactions can be effectively applied for the development of the agricultural sector too. However, for this purpose some amendments must be made in their basic structure, while the general and basic principles must be followed; and should not be compromised under any circumstance.[445] In addition, there are some basic philosophies working behind all these classical modes and strongly emphasized by the jurists to be followed. For instance, the basic philosophy behind the transaction of *Mudārabah*[446] is that cash must flow from the wealthy towards the poor and not vice versa. Similarly *Ijārah*

---

allowed by Islamic law to be traded. In this deal, the customers buys share of the financial institution in the asset gradually until and unless he becomes the solitary owner of the commodity. Sometime, the ownership of the commodity is transferred to the customer as a gift when the bank gets back its liquidity along with a reasonable profit.

[444]It is a typical contract of Islamic commercial law, designed especially for agricultural development, where an owner of a garden shares its yields with another individual as a return for his services related to the irrigation of the same garden. This transaction is legally recognized for the purpose to provide a share in the produce for those individuals of the society who do not own land at all or have a very small piece of land, not adequate in terms of production to accomplish his family food requirements……. Imām Kāsānī, a renowned Hanfī jurist, defined *Musāqah* as "a contract of work for part of the produce along with the condition of validity"…… Abū Bakar ibn Mas'ūd Kāsānī, *Badā'-al-Sanā' fī Tartyb-al-Sharā'*, vol.6,p.

[445]For instance as general principle of Islamic commercial law, the sale of non-existing thing is strictly forbidden in *Sharī`ah*(Abū Dawūd, Sunnan, Hadith No. 3503). However, the contract of *Salam* (advance payment sale) is an exception to this general rule. But it does not indicate that the commodity should be non-existing utterly, and in this case too, there are diverse elucidations of the jurists. For example, according to Hanafî school of thought, the object of *Salam* must be in existence at the time of contract; where it means that it must be available in the market, though not in the session, from the date of the contract up to the time of delivery declared in the contract.(Wahbah-al-Zuhaylī, *Al-Fiqh-al-islāmī –Wa-Adilatuhū*, 'Aqd-ul-Salam, vol.5.p.3613). It evidently means that if the commodity is not available in the market at the time of the contract, *Salam* cannot be affected in respect of that commodity, even though it is expected that it would be available in the market at the date of delivery. So, here the rule related to the prohibition of non-existing commodities' sale is still followed in its spirit with some relaxation i.e. existing of commodity may not be present in the session of the contract. In short, It is important to note that a *Salam* is not an absolute sale of non-existent goods; it is rather a special sale of non-available goods at the session of the contract which should be available in the market at the time of the contract or at least would be available at the time of delivery.Similarly, *Ribā*is strictly prohibited by*Sharī`ah* in all possible forms and, therefore, this principle can not be violated under any stretch of explanation.

[446]*Mudārabah* is also called *Qirād* (means'surrender' in *Arabic* language as the owner of the capital surrenders his capital)in Islamic commercial law. It isa sort of partnership where one of the parties provides capital while the other provides work in the shape of expertise and management. The previous party is called *Rab-ul- Māl* while the latter is called *Mudārib*. The profit accrued from the business is divided according to the agreed ratio, while the loss is solely borne by the capital provider.

does not mean transfer of ownership, rather it is a transfer of usufructs to a person who does not have either the ability to purchase the commodity or nor needs a commodity for a long time, and hence, not interested in its ownership. Like wise *Qard Hasan* (charitable loan) should be given only to a person for the fulfillment of his basic needs. It should be solely based on charity and, therefore, should not be used as a source of profit under any condition. Therefore, in the coming discussion, the original concepts of all these modes along with their basic philosophies will be discussed in the light of the classical Muslim jurists' work, followed by their practical and realistic application to all agricultural sectors with more emphasis on local farming, owing to the fact of its importance in the agricultural development of Pakistan. In addition, the proposed theory should be tested through an exhaustive data sampled from the farmers and other stakeholders of agricultural finance. It is intentionally done in order to in line the proposed models in such a way which can be effectively applied for the solutions of farmers' problems. Being a hub of farmers, a special attention must be given to the problems faced by the farmers in rural parts of the country. Moreover, some case studies of various modes, showing success or failure of the financial institutions will be critically analyzed to overcome the existing deficiencies in Islamic agricultural finance.

5.3.1 *Qard Hasan* Based Model and Financing Agriculture

5.3.1.1 Theoretical Background of *Qard Hasan*

The Lord of the Universe (*Allah SWT*) and the real and absolute owner of all wealth, guides Muslims to pass on some of this wealth that He provides to them, to those who are in need. This guidance has been provided in various verses of the Holy *Qur'ān,* "Give them something yourselves out of the means which Allah has given to you"[447] Another verse refers to the same as, "And spend out of what We have provided for them"[448] The Holy *Qur'ān* also confirms the uneven distribution of wealth by stating, "And Allah has favored some of you above others in worldly gifts".[449] While owing to the reality of inequity in terms of wealth, Islam asks the more fortunate individuals, who are financially stable, to financially help the less fortunate.

---

[447] *Qur'ān* 24:33.
[448] *Qur'ān*2:3.
[449] *Qur'ān*16:72.

The word "*Qard*" and "*Hasan*" are Arabic's equivalent of the English word loan, and beautiful, respectively. According to well renowned Hanafi jurist Imām Kasānī, its literal meaning is to "cut off". In the view of Hanafī school of thought, it technically means "a specific transaction in which one party gives fungible property to another party for the purpose of receiving from him the fungible property back without any excess".[450] Some of the contemporary Muslim scholars signify its technical meaning as "it is a voluntary loan without the lender's expectations of any return on the principal".[451] Keeping in view the classical and contemporary scholars' definitions it can be said that *Qard Hasan* is a charitable contract in which one party gives a determined sum of money to another party, and the second party returns it without any excess to the principal amount when he is able to repay it.

Like other commercial transactions, Islamic commercial law has explained a set of rules and regulations for *Qard Hasan.* Some of these rules are related to *Muqrez* (creditor) while some others to *Muqtarez* (debtor). However, in the present work they are discussed in a combined way in order to avoid width of discussion and describe the issue in a comprehensive and short way.

As the basic philosophy of *Qard Hasan*, such a loan is given by lender to borrower (debtor) for cooperative and charitable purposes; therefore, he is not allowed to demand any excess over his advanced amount. An adherence to this philosophy is strictly commanded by *Sharī`ah* through various injunctions of the Holy *Qur'ān.* The classical Muslim scholars are unanimous that excess paid to the lender voluntarily is not only allowed but also recommended in Islamic law. Ibn Hazm and Kasānī have mentioned the same principle in their splendid work.[452] Thus, if the excess is not stipulated in the contract nor guaranteed by the prevailing custom, then such additional amount over the principal amount is legitimate in Islamic law.[453]

---

[450]Kāsānī, *Bādā'i'al-Sanā'i'*, Kitab-al Qard, vol.7,pp.581-583.

[451]Hossein Askari, Zamir Iqbal, Abbas Mirakhor, *New Issues in Islamic Finance & Economics*, (1st Ed.) Singapore: John Wiley & Sons, 2009 (pp197-210).

[452]Ibn Hazm al Zaherī. *Al Muhallah*, Dar-al-Fikr, Berut Lubnan, Kitab-al-Qard, 1st Edition 1988, vol 5, pp. 77 86; Kāsānī, *Bādā'i'al-Sanā'i'*, Kitab-al Qard, vol.7, pp.581-583.

[453]Shawkānī, *Nayl al-Awtār*, vol. 5, pp. 259 337; Kāsānī, *Bādā'i'al-Sanā'i',* Kitab-al Qard, vol.7, pp.581-583; Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū* vol.5, pp.3786-4028).

Such payment is called *Husn-al–Ada* (the best repayment).[454] However, this provision must be practiced sparingly and with utmost care; otherwise, the excess payment might become a custom and thus lose its permissibility. Moreover, the creditor is not allowed, while misusing his position, to get any sort of benefit from the debtor neither in the form of work nor in the form of service. This rule is backed by the tradition of the Holy Prophet (SAW).[455] As *Qard Hasan* is always given to help an individual at a difficult time, the time of repayment cannot be specified in the contract deed. The debtor is given an opportunity to repay the amount whenever he gets the financial ability to do so. Kasānī endorses the same principle.[456] In addition, it is advised that the same may be remitted as charity. In this regard *Qur'ān* says

> "And if any debtor be in straitened circumstances, and then grant him respite till a time of ease. And that you remit it as charity shall be better for you, if only you knew"[457]

The theoretical background of *Qard Hasan* mentioned in the above lines clearly indicates those aims and objectives which are planned by *Sharī`ah* from its insertion in the domain of Islamic commercial law. These objectives are social welfare and support as mentioned by some renowned scholars in their work on *Maqāsid-al- Sharī`ah* (objectives of Islamic law).[458] The rules and regulations for this interest-free based transaction are, therefore, kept very much flexible in order to achieve such objectives in the best possible way. The Islamic financial institutions should show adherence to all these set of principles while providing interest free loans to the deserved applicants. The scheme will create the atmosphere of social welfare and support, if applied both in terms of spirit and letter, and will eradicate poverty largely from the social set up.

---

[454]Some of the Muslim jurists, particularly those who belong to the *Hanafī* school of thought, consider the repayment of a debt along with such excess (that is not stipulated in the contract QH) as the best repayment (*Husn-ul -Adā*) which is also advised by the Holy Prophet (SM).Kāsānī, *Bādā'i'al-Sanā'i'*, Kitab-al Qard, vol.7, pp.581-583.

[455]Shawkānī, *Nayl al-Awtār*, vol. 5, pp. 259 337.

[456]Kāsānī, *Bādā'i'al-Sanā'i'*, Kitab-al Qard, vol.7,pp.581-583.

[457]*Qurān* 2:28.

[458]Mohammad Hashim Kamali,*Maqasid al Shariah: The Objectives of Islamic Law*, http://www.sunniforum.com/forum/showthread.php?6176-Maqasid-al-Shariah-The-Objectives-of-Islamic-Law(accessed: 25th August, 2014).

5.3.1.2 *Qard Hasan* as a Financing Tool for Agriculture (an approach of the Islamic banks/Islamic financial institutions)

Islamic financial system consists financing on two dimensions i.e. one for charitable purposes which is called *Qard Hasan*, and the other for trade that includes *Murābahah, Musāwamha, Salam, Istisnā‘, Mus*h*ārakha, Ijāraha* etc. In the former case, an individual advances money to another individual without getting any increase over and above the principal amount, whereas in the latter case money is invested for the purpose to earn profit through various ways.[459] The aims and objectives, of the Islamic financial system, of creating equity in the distribution of wealth, cannot be achieved without implementation of both these dimensions. It is clear since the evolution of commercial institutions that the obsession of profit maximization allows little room for extending interest free loans. However, a look at the financial statements of the Islamic banks and financial institutions reveals that they too have left this high potential area as unexplored and widely ignored. This is an alarming situation at the global level where the financial institutions do not contribute actively in social development and, consequently, the concept of Corporate Social Responsibly (CSR) has been introduced. While following the same concept, a comprehensive model on *Qard Hasan* basis has been proposed in the present work for financing agriculture, particularly its major sub sector i.e. local farming.

Before the discussion of the proposed model, some preliminary and crucial aspects of the issue should be studied for the purpose of better understanding of the proposed models. The idea of *Qard Hasan* is utterly a new suitable concept that needs to be deeply embedded into the contemporary Islamic financial system. The more social and cooperative nature of this mode, had up to now, induced the Islamic banks and other Islamic financial institutions to stay clear of its insertion into their financing operations. There are chances that this approach may not gratify those who invest money with the sole purpose of profit maximization. They would simply snub such a model on the premise that their institutions are not created for charitable purposes. Some additional steps, therefore, have to be taken, along with the provision of a strong theoretical background, to convince the Islamic banks regarding the practicability of *Qard Hasan.* The most important role, in this regard, can be played by the central bank i.e. the State Bank of Pakistan. It

[459]Muhammad Taqi Usmani, An Introduction to Islamic Finance, p.29.

can issue more elastic regulatory laws for financing on the basis of *Qard Hasan*, (particularly to the agricultural sector), help out the Islamic banks in their recovery, provide subsidies on agricultural products to the farmers through these financial institutions, and give incentives to the financial institutions who become instrumental in the development of the society by providing *Qard Hasan*. *Sharīʻah* scholars, particularly those who are associated with Islamic banks in the capacity of *Sharīʻah* advisors, can also play their part. They can try for shifting the mindset of Islamic bank shareholders form profit maximization to cooperative and social welfare. They should educate these shareholders regarding the basic philosophy of Islamic finance, which lies in the development of the society, making it affluent. They should create awareness in the public regarding the importance of Islamic banking and its role in the elimination of *Ribā* (interest) from the Muslim society. They can convince the public to build their savings and trade with the Islamic financial institutions through modes such as *Mushārakah, Diminishing Mushārakah, Mudārabah, Musāsqat, Muzāraʻat, Murābahah, Musāwamha, Salam, Istisnāʻ* etc. In order to foster smooth implementation of the proposed *Qard Hasan* model, it is the duty of the state to legislate strong recovery laws, black list habitual non payers, and compensate Islamic financial institutions in case of non repayment of loans in the wake of low yields owing to natural mishaps such as earthquakes, mudslides, hail storms, floods etc. All these steps will not only help in practical application of the proposed model but will also help in achieving the intended results i.e. social welfare and support.

It is a valid question that why financial institutions are so reluctant to finance the agriculture sector, both for crop and non-crop activities. Once these reasons are identified, it will become comparatively easier to propose an appropriate model for financing agriculture based on *Qard Hasan.* It will also pave a way to convince the financial institutions to launch interest free loan programs.

There are many reasons why financial institutions are very reluctant to finance agriculture through *Qard Hasan.* Firstly, agriculture sector is prone to many natural risks like droughts, floods, hailstorms, earthquakes, mudslides, and a multitude of other mishaps.[460] In addition to

[460] Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50.

the natural risk, there are some other un-natural risks faced by agriculture sector. These risks include economic risks, operational risks, social risks, political risks etc.[461] All these risks compel the financial institutions to think hard before financing agriculture by any mode of financing, including *Qard Hasan.* The risks in agriculture, however can be mitigated through various risk management techniques and methods proposed by the experts of agricultural finance. These techniques include various insurance programs like index based weather insurance, crop insurance, multi peril crop insurance, by strengthening the credit supervision process, prior information given by the government regarding the weather (for this purpose weather station can be established), establishment of emergency cell in order to deal with unpleasant natural event etc. Secondly, in Pakistan some of the prominent scholars and institutions are against the legitimacy of Islamic banking and its various operations.[462] They hold the opinion that the current Islamic banking practices are un-Islamic.[463] Therefore, the customers, particularly the religious minded, would not resort to interest-free loans from financial institutions. Thirdly and more importantly, major agricultural activities are carried out in rural parts of the country owing to the fact that a bulk of farmers are living in such areas. Unfortunately, the cultivation and harvesting methods used by the rural farmers are very classical in nature. Therefore, there is always the possibility that they may not produce enough yields, sufficient to nourish their family, keep seed for the next season and pay the advanced loan. This low production rate compels the financial institutions to stay from the provision of loan on the basis of *Qard Hasan.*

Because of these reasons, the market share of financial institutions is zero as far as *Qard Hasan* is concerned. The following table and graphical presentation can be cited as evidence in this connection.

---

[461] Matthias Bickel, *Martin Klein, Rethinking Rural and Agricultural Finance –The African Case*, international Platform, , https:// www.rural21.com/.../R21_Rethinking_rural_and_agricultural_finance_0... (accessed: 17th March, 2014).

[462] These scholars include Justice Tanzeel ur Rehman, Abdul Mujeeb Ansari, Hassan Zaman Akhtar, Mulana Mufti Abdul Wahid, Javeed Akbar Ansari, Mulana Saleem ullah Khan, Imran Ihsan Khan Nyazee etc. The Jameea al Uloom al Islameya has issued a bulk of Fatwa agiant the legityimacy of contemporary Islamic banking.

[463] Muhammad Tahir Mansoori Tahir , *Use of Hiyal in Islamic Finance*, journal of Islamic Business and Management, Riphah International University Islamabad Pakistan, 2011 Issue No.1,November 1st 2011, vol. 1, pp.70-71.

Market Share of Islamic Modes of Financing (Rs. in Millions)

Mode of financing	**CY 04**	**CY 05**	**CY 06**	**CY 07**	**CY 08**	**CY 09**	**CY 10***
Murabaha	57.4	44.4	48.4	44.5	36.5	42.3	44.9
Ijara	24.8	29.7	29.7	24	22.1	14.2	12.7
Musharaka	1	0.5	0.8	1.6	2.1	1.8	2.9
Mudaraba	-	-	-	0.3	0.2	0.4	0.2
Diminishing Musharka	5.9	12.8	14.8	25.6	28.9	30.4	29.5
Salam	0.7	0.6	1.9	1.4	1.8	1.2	1.4
Istisna	0.4	1.4	1.4	1	2.9	6.1	5.8
Qard-al - Hassan	-	-	-	-	-	-	-
Others	9.8	12.1	3	1.6	5.4	3.6	2.6

Table 10: Market share of Islamic modes of financing

Source: Economic Survey of Pakistan 2009-10

Graphic Representation:

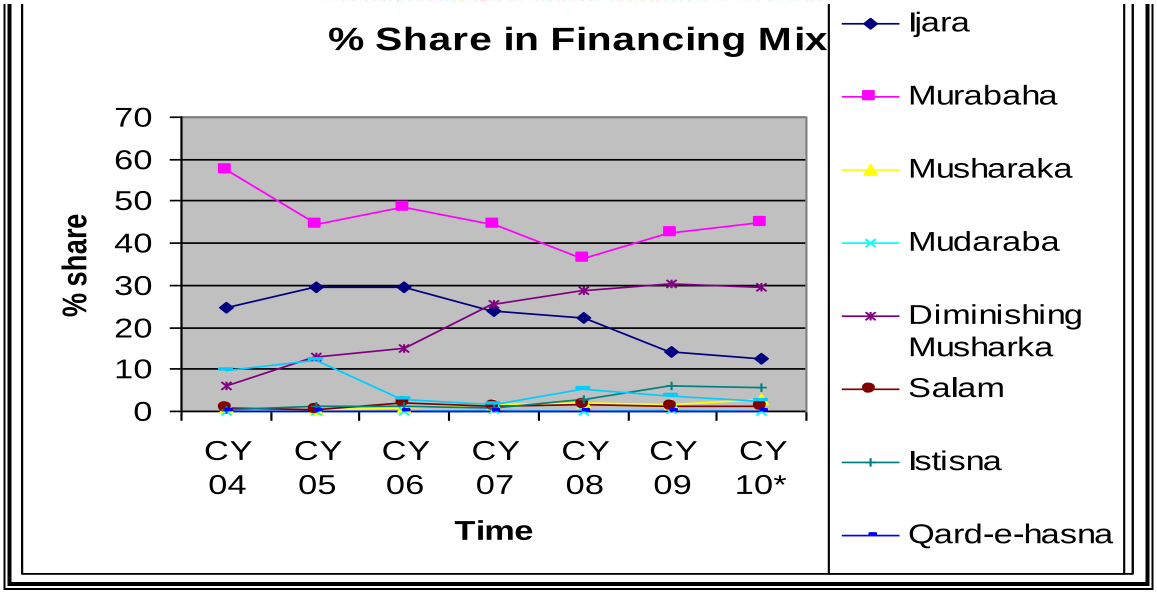


Figure 3: Share in financing mix

Source: Economic Survey of Pakistan 2009-10

5.3.1.3 Proposed Model of Qard Hasan for Agriculture Sector

Islamic commercial law endorses the concept of "Juristic Person" and therefore, the Islamic financial institutions must perform all those duties and obligations demanded by *Sharīʻah* from a natural person.[464] These obligations include taking of charitable and cooperative measures to help poorer segments of the society. As the majority of farmers belong to the poor class, therefore, *Qard Hasan* is the best option for financial institutions to fulfill such a social obligation. Majority of farmers expect the same role from Islamic banks and Islamic financial institutions (see figure No.5).

There are many sources available to such financial institutions from where they can allocate funds for the provision of such beneficial loan. These sources include the "charitable fund"[465]

---

[464]Muhammad Taqi Usmani, An Introduction to Islamic Finance, p.10.

[465]Such charitable fulnds are avialble with almost all Islamic banks and can be used for the provison of *Qard Hasan*. In this reagsrd Muhammad Taqi Usmani Says "For the purpose it was suggested that the client, when entering into a Murabha transaction, should undertake that in case of default of payment at the due date, he will pay a specified amount to a charitable fund maintained by the bank. It must be ensured that no part of such amount shall form part of the income of the bank. However, the bank may establish a charitable fund for this purpose and all amounts

that is held by almost every Islamic bank, the capital of the Islamic financial institutions, funds provided by the government for the development of agricultural sector, deposits of the customers,[466] etc.

It is a valid question which can be raised by the shareholders and other stakeholders of the financial institutions that what would be the expected benefit of such a proposed model for them. This question is indispensable to be asked owing to the fact that all financial institutions are based on the philosophy of profit maximization. They are not benevolent institutions to provide their liquidity without having some material benefit. The question, therefore, must be answered with the same mindset; otherwise, satisfaction of such stakeholders would become a difficult job not only for academicians but also for the policy makers.

There are many benefits for Islamic banks and other Islamic financial institutions in the provision of *Qard Hasan.* Such benefits are divided further into two classes i.e. material and immaterial. The former consists of those benefits which can bring liquidity while the latter may have some positive impact on the overall business of the institutions. For instance, the bank on the advancement of a loan on the basis of *Qard Hasan* can take service charges from the farmers. Such charges include administrative cost, transaction cost etc. There is no objection from the *Sharī'ah* point of view if such charges are not stipulated in the contract, nor allowed by the prevailing customs, nor related to the principal amount and not even related to time. According to some scholars such charges will be limited only to the original administrative cost.[467] In addition, the farmers, on their own free will, can give some extra amount over the principal sum to the financial institutions. However, this additional amount will be considered prohibited when

---

credited therein shall be exclusively used for purely charitable purposes approved by the Sharī'ahboard. The bank may also advance interest free loans to the needy persons from this charitable fund" Ibid,P.138.

[466]The Islamic financial institutions and Islamic banks can also utilize current accounts for QH as these are considered *Amānah* (trust) from the perspective of Islamic commercial law and hence no surplus is paid to the account holders by the financial institutions. The same philosophy can be applied to saving and fixed deposit accounts. The procedure here, however, may be a little complex and hence requires further academic research from competent scholars of the field…

[467]Mohammad Omar Farooq, *Qard Hasan, Wadiah/Amanah and Bank Deposits: Applications and Misapplications of Some Concepts in Islamic Banking,* Arab Law Quarterly, 25 (2). 2010 Available at SSRN: http://ssrn.com/abstract=1418202. (accessed July 11, 2011).

it is the outcome of any contractual obligation or any prevailing customary practice.[468] But if it is not so, then such amount will treated legally as a *Hibah* (gift) from debtor to creditor.[469] In view of some researchers if the farmer gives any excess over and above the principal loan by his own free will (keeping in view his financial ability), it will not only help the Islamic banks to grow but will also encourage them to advance more loans to the agricultural sector in future. However, majority of farmers (respondents) are unwilling to pay the extra amount (see figure No.6). It is, therefore, duty of the state to educated people and create awareness in the illiterate farmers regarding their role in the development of Islamic financial institutions.

Another benefit to the Islamic banks from advancing *Qard Hasan* to the local farmers is that it will attract the peasants to deposit their savings with the banks from which they secured the interest- free loan. The collected data shows that majority of farmer are ready for the same (see figure No.7). This approach of farmers may be based on the basic teaching of the Holy *Qur'ān* in which the believers are commanded to return good for good.[470]

The financial institutions can also use *Qard Hasan* for getting some immaterial benefits. Among these, and the most important one, is their publicity and advertisement among the farmers' community. By the provision of such interest- free loans, they will attract and even compel the farmers to deposit their savings and trade with financial institutions on the basis of some recognized modes of Islamic commercial law i.e. *Murābahah, Musāwamha*, *Salam*, *Istisnā',* Ijārah, *Mushārakah, Diminishing Mushārakah, Mudarābha, Musāsqat, Muzāra'at* etc. This will surely increase customership of financial institutions which may allow the opening of more branches; and consequently expansion of the business and profit. However, these benefits require long-term policies and planning, duly accepted and agreed by the shareholders of the financial institutions. Keeping in view all these benefits (material and immaterial), it is desirable that the Islamic banks and other financial institutions advance interest free loans to the agricultural sector, which will not only help poorer farmers, but will also help these institutions to expand their business, especially in the rural areas.

---

468 Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol.5, pp.3786-4028.

469 Kāsānī, *Bādā'i'al-Sanā'i',* Kitab-al Qard, vol.7, pp.581-583; Ibn Hazm -al -Zaherī.*Al Muhallah*, vol 5, pp. 77- 86.

470 Is there any Reward for Good - other than Good? *Qurān* 55:60.

Ibn Hazm mentions, that *Qard Hasan* as per the Islamic financial system is used as a general term, and covers not only cash or currency, but applies to all consumable goods.[471] Kasānī , the author of *Badā'-al-San'aī*, confirms the same by saying that *Qard Hasan* may be in the form of any consumable goods which is weighable, measurable, or countable and that the return of the same goods will be applicable at the time of the culmination of the *Qard Hasan* .[472] The Islamic banks and other financial institutions may, therefore, apply this rule for providing farm inputs e.g. seeds, fertilizers, pesticides, insecticides, and herbicides, sprays etc. Similarly, a farmer who is engaged in poultry, fish, or dairy farming, may be helped with the inputs (equipment, tools, and consumables etc.) which are normally required for managing such farms as profitable economic units.[473] Majority of respondents (farmers) show their willingness for this sort of arrangement (see figure No.8).

However, a very pertinent question arises here which needs to be analyzed and answered. Since, Islamic jurisprudence requires that *Qard Hasan* can also be provided in kind that has to be returned with the commodity of same quality, quantity, and condition; would it not pose a serious handling/storage problem for the financial institutions when various commodities are returned by the borrowers.

Unlike conventional banks that predominantly deal in cash, the Islamic banks/financial institutions are required to adopt the innovative trade modes to undertake *Murābahah*, *Salam* and *Ijāra* schemes in true Islamic spirit. Usmani endorses the same view as he urges the financial institutions to uphold the basic requirements of Islamic economy by creating special cells dealing exclusively in commodities. These cells will facilitate the purchase of commodities through *Salam* for onward sale in the spot market.[474]

The most central issue for Islamic banks and other Islamic financial institutions is the recovery of liquidity advanced on the basis of *Qard Hasan.* However, recovery is not the exclusive issue and there are some supplementary problems related with it i.e. litigations,

---

[471] Ibn Hazm al Zaherī. *Al Muhallah*,, Kitab-al-Qard, vol 5, pp. 77- 86.
[472]Kāsānī, *Bādā'i'al-Sanā'i',* Kitab-al Qard, vol.7, pp.581-583.
[473]*Financing Scheme for Small Farmers*, Agricultural Credit Department, State Bank of Pakistan (accessed: 28th February, 2014).
[474]Muhammad Taqi Usmani, An Introduction to Islamic Finance, p.193.

liquidation of securities etc. As far the conventional banks are concerned, they do not usually have such problems in their recovery techniques owing to the fact that they can reschedule the amount due and can also impose penalty in case of delay. However, the Islamic commercial law does not accept such concepts. Therefore, it is necessary to discuss the concept of recovery from the perspective of *Sharī'ah* with minute details in order to address concerns of shareholders in this regard.

It is a matter of fact that *Qard Hasan* is always given for the purpose to help an individual at the time of ominous need. Based on this philosophy, if the debtor is not in position to repay the loan, rescheduling is recommended by *Sharī'ah* with a condition that no increase will be made in the principal amount. However, this relaxation may be misused by dishonest farmers, and hence, some strict policies must be adopted by the financial institutions in this regard. The Islamic law also has also predicted the same exploitation of the relaxation and, therefore, has placed some strict rules and regulations for deceitful defaulters. According to a *Hadīth* of the Holy Prophet (SAW) "The well-off person who delays the payment of his debt, subjects himself to punishment and disgrace".[475] In another hadith, the same strictness has been showed, "The intentional non payer of debt is tantamount to transgression".[476] The repayment on due time has been encouraged by the Holy Prophet(SAW) by saying, "If I had a gold equal to the mountain of Uhud, it would not please me that it should remain with me for more than three days, except an amount which I would keep for repaying debts".[477] In another hadith it is said, "The best among you is who repays the debt in the best way".[478] While merging all the above three traditions, some regulatory frameworks can be developed by the State Bank of Pakistan as a guideline for all financial institutions to recover their liquidity in the best possible manner. The central bank should not leave the making of such laws solely at the discretion of the financial

[475]Ibn Hajar 'Asqalāni.*Fath al Bārī –fī- Sharh Sahīh- al -Bukhārī*, (Dar ul Misr Li tabā't, First Edition 2011), pp.88-89.

[476]Ibid, pp 88-89.

[477]Muhammad Mohsin Khan, *Bukharī*, English version. Islamic University al Medina al Munawarah, Kazi Publication Pakistan, sixth Edition pp.335-339.

[478]Shawkānī, *Nayl al-Awtār*, vol. 5, pp.259 337.

institution as it did in the past.[479] In this regard some guideline can also be taken from the recovery standards mentioned in Accounting and Auditing Organization for Islamic Financial Institutions. While making recovery procedure, balancing techniques should be used in framing rules and regulations in order to protect interest of all stake holders i.e. farmers, financial institutions etc. in addition, the humiliating contemporary methods used for the recovery of loan, particularly by the conventional financial institutions, should be avoided. Besides, the existing laws related to mortgage, pledge, liquidation of securities, blacklisting, etc should be revisited and some substantial amendments will be made in them from *Sharī'ah* perspective. In addition, personal security or group based security should be preferred rather than mortgage or pledge, as the latter are not favored by the farmers (see figure No.9). The time for the repayment of loan should also be revised and a reasonable time period should be described for the recovery of loan. The recovery period should be determined from case to case, place to place, individual to individual, situation to situation, purpose to purpose etc and no strict and rigid time period will be for all farmers. In other words, each and every farmer should be dealt separately after performing profound pre-contractual negotiations with him.

The idea will of course breed new problems for the banks and pose some new questions for the scholars and researchers of Islamic *Sharī'ah*, at least in the initial stages of its practice. However, these would be resolved over time with sincere and collaborative efforts of the bankers and scholars. Fortunately, a rich source of *Sharī'ah* knowledge already exists, which needs to be studied and interpreted in the light of the prevailing environment. The basic principles of *Sharī'ah*, already established through intensive and extensive research, may be applied to the contemporary practices to find solutions for emerging problems and new queries. In addition, it is essential that the benefit is actually passed on to those for whom it is intended, and

---

[479]The State Bank of Pakistan, being a central bank, does not play its required role in this regard and has left the issue to the discretion of the banks to determine and prepare their own procedure mechanism for the recovery of loan. The following statement can be cited as evidence "Banks/DFIs are also encouraged to prepare comprehensive recovery procedures, which should interalia specify certain triggers for taking specified actions while requiring reasons to be recorded in writing in exceptional cases where specified actions are not being taken"*Prudential Regulations For Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan,p.6, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

unscrupulous elements are not allowed to misuse the facility. This is important, otherwise the whole purpose of the exercise will be defeated and the true spirit and philosophy of this mode will be violated. A proper application of *Qard Hasan* for the deserving will not impose any financial burden on this poor segment of the population, and will in earnest help raise their living standards.

Diagram of the Proposed Model

Qard Hasan based model

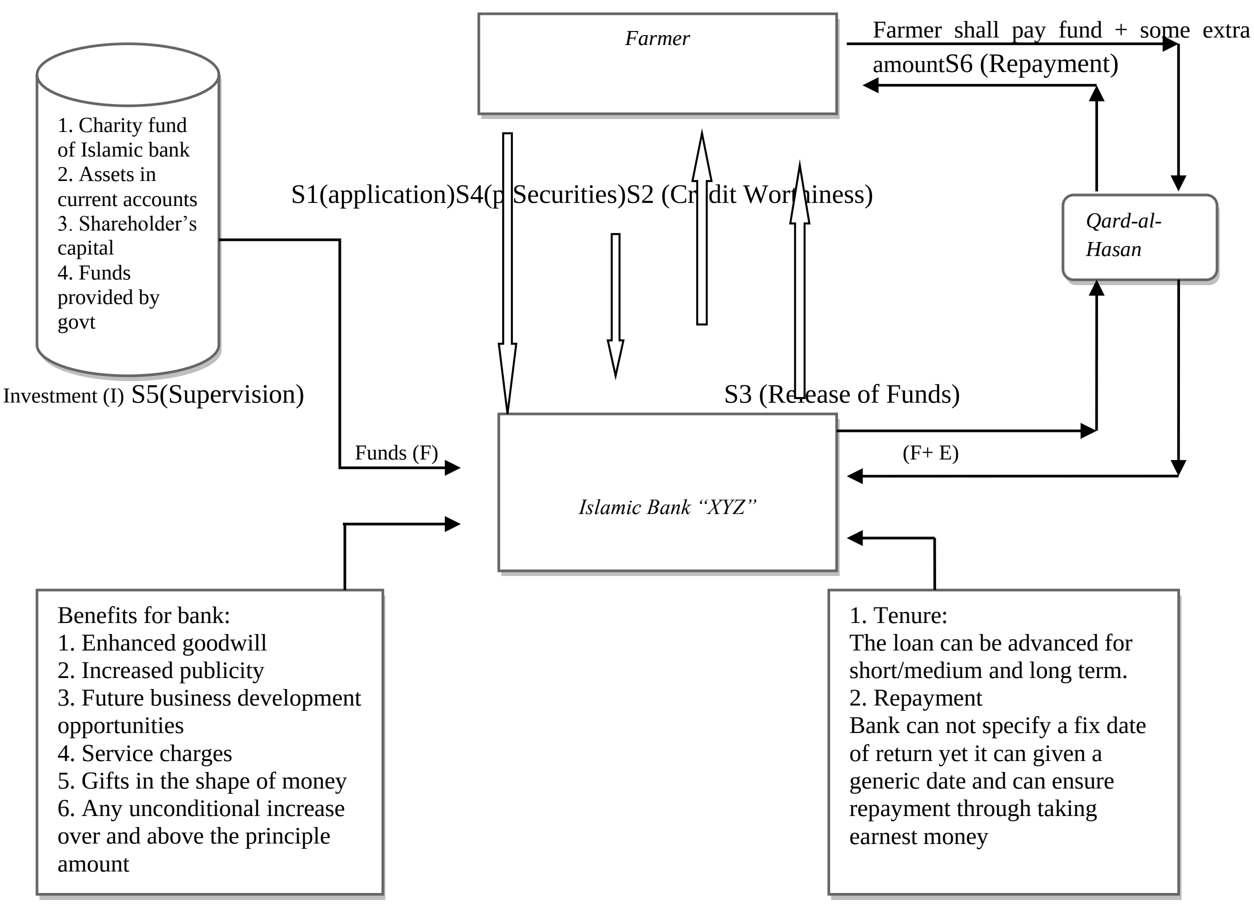


Figure 4: Qard Hasan based model

5.5.1.4 Trail of the Proposed Model of *Qard Hasan* (survey)

A focused group based study was conducted for the purpose to check the viability and practicability of the proposed model for agriculture sector, particularly local farming. The farmers were asked various questions related to the whole mechanism of the model. The following response had been received.

- The collected data proves that the majority of respondents (farmers) have supported the interest-free loan. The following graphical presentation has been made from their response.

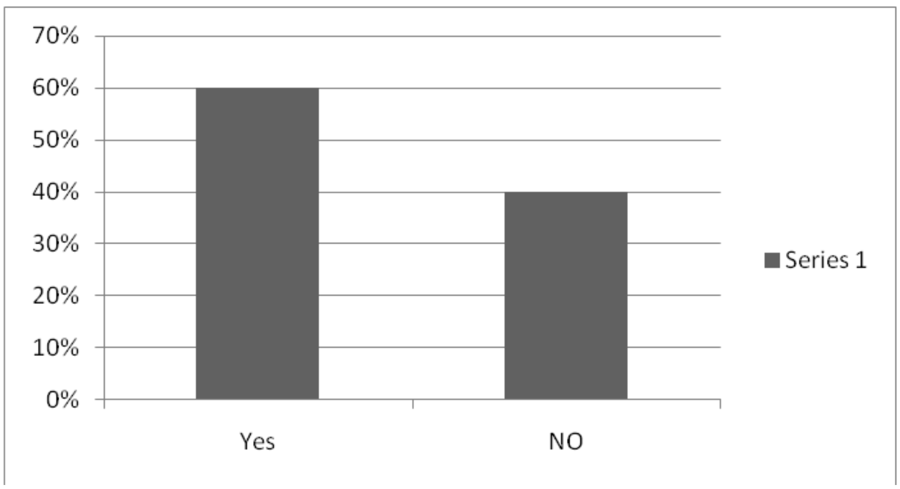


Figure 5: Farmers' support Model of Qard e Hasan

The graphical presentation clearly indicates that even majority of farmers i.e. 60% support the proposed model of *Qard Hasan* and expect that financial institutions can provide them interest-free loans.

- Majority of farmers do not show their consent for giving some extra amount over the principal sum when they were asked about the same. However, through the creation of awareness among the farmers regarding the importance of Islamic banking and their required role in the development of the same may bring positive changes in the current situation. The following graphical presentation may explain their response in the best possible manner.

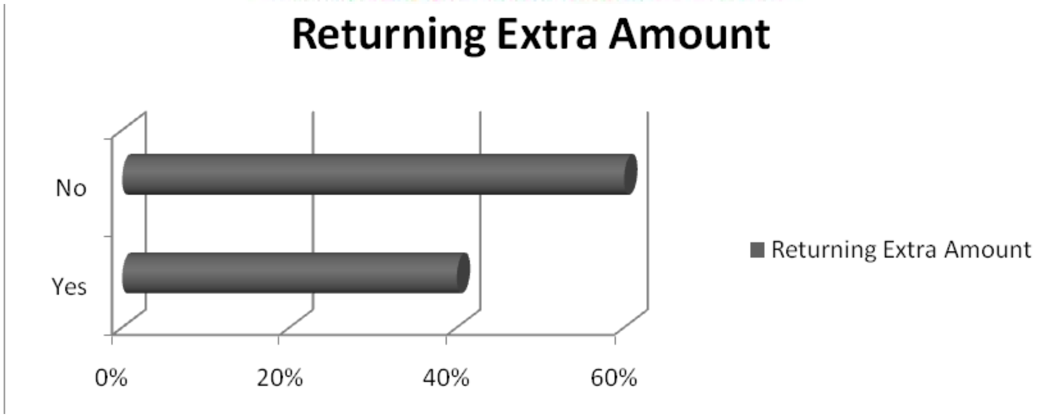


Figure 6: Returning extra amount

- The farmers have shown very positive response when they were asked whether they would deposit their savings with the same bank from which they secured free interest loan. The following graphical presentation may confirm the same.

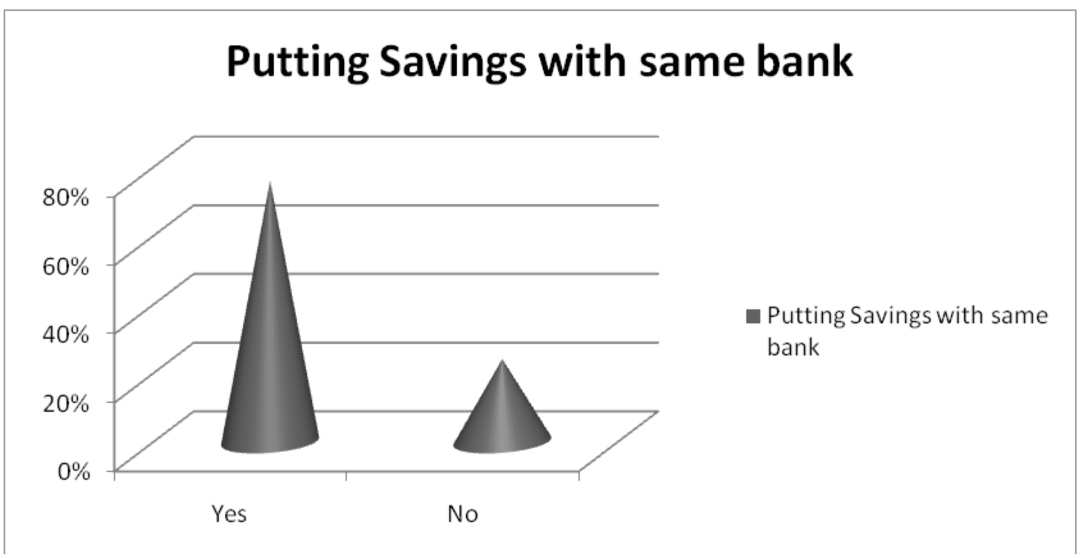
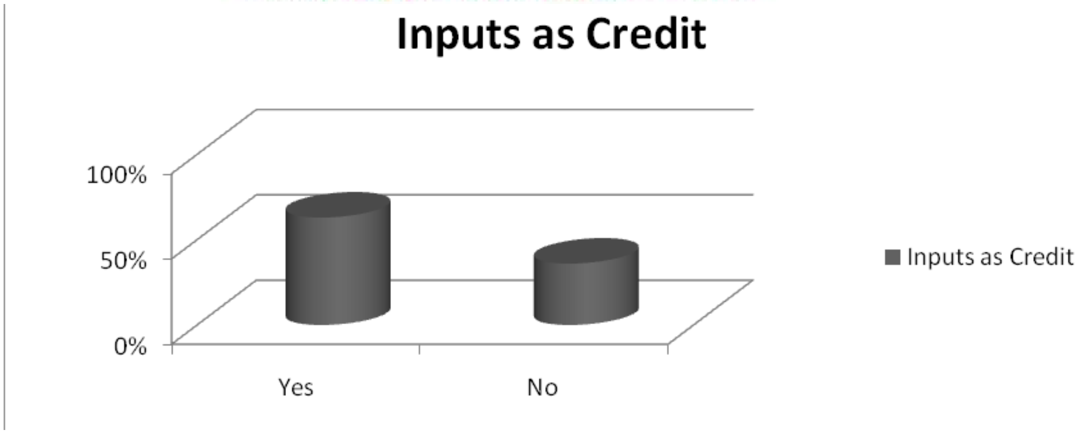


Figure 7: Putting Savings with same bank

- Data shows that majority of farmers are willing to get agricultural inputs rather than cash from the financial institutions. The Islamic banks and other Islamic financial institutionsare, therefore, required to have a special cell for dealing inputs.



•

Figure 8: Inputs as credit

- Majority of farmers has responded negatively to the securities and collaterals, required by the financial institutions for the provision of credit facility. The following graphical presentation had been drawn from the collected data.

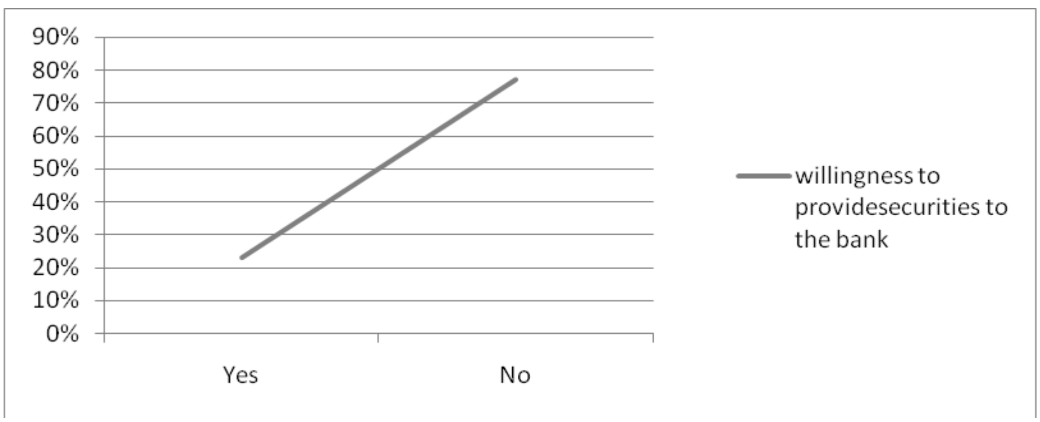


Figure 9: Farmers' willingness to provide securities

However, they show their consent to provide personal guarantees in case when these are indispensable for the provision of credit. Therefore, the personal guarantees are recommended in the proposed model rather than mortgage and pledge.

- All farmers have responded positively when they were asked about the repayment of a secured loan. The following graphical presentation can be cited as an evidence of the same fact.

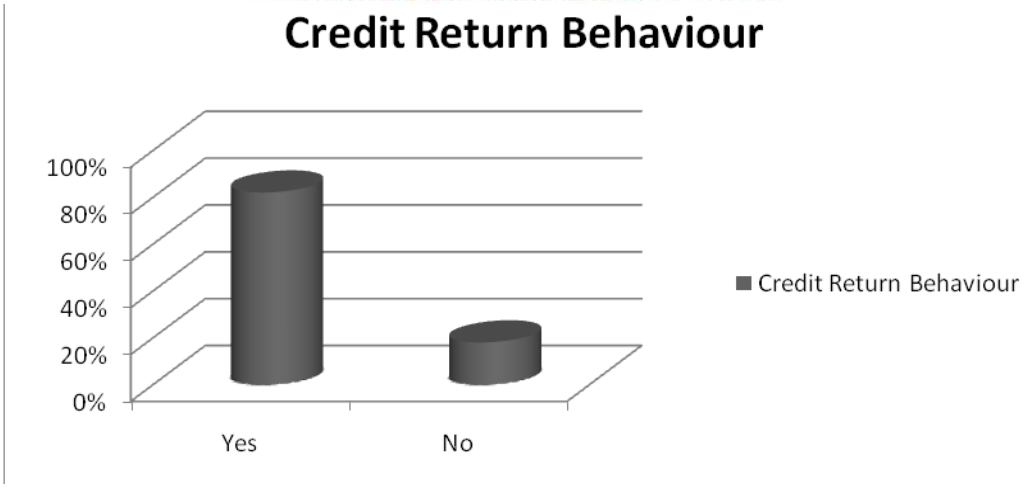


Figure 10: Credit Return Behavior

- Majority of farmers do not use the secured credit for intended agricultural activities rather use it more for social purpose, and this tendency consequently affects the production rate. Data collected from farmers have proved the same fact when they were asked about the possible use of secured credit.

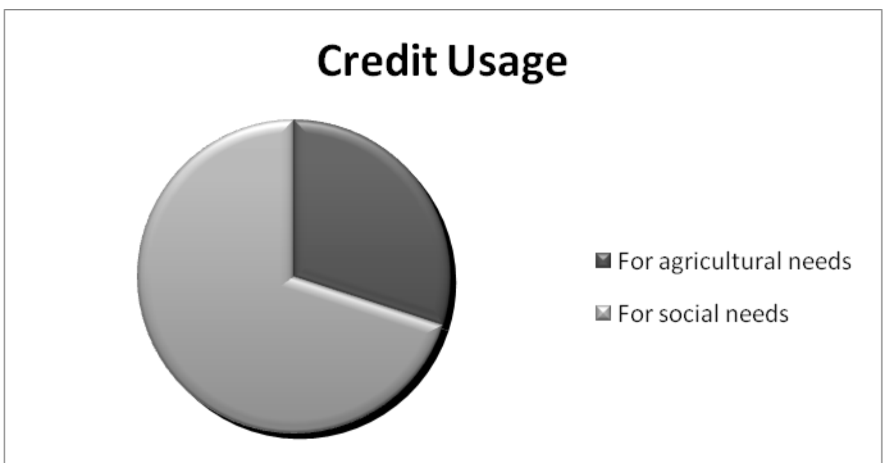


Figure 11: credit usage

However, this problem can be solved through effective supervision of credit by the Islamic banks and other Islamic financial institutions. The active supervision, therefore, has been recommended in the proposed model.

5.3.2 *Mushārakah* Based Model and Financing Agriculture

5.3.2.1 Theoretical Background of *Mushārakah*

Islam, a religion of peace and prosperity, emphasizes mutual cooperation and support among its followers in every sphere of their lives. After *Hijrah*, the migration of Muslims from *Makkah* to *Madina* undertaken due to persecution at the hands of the non-believers of *Makkah,* the Prophet of Islam (SAW) created a brotherhood among *Muhājerīn* (migrants from *Makkah*) and *Ansārs* (locals of *Medina*). Such was the spirit of mutual cooperation and support that *Ansārs* willingly shared half of their belongings with the *Muhājereen*. It is because of this reason that Allah (SWT) has showered his blessings on them as revealed in the Holy *Qur'ān* in the shape of His happiness.[480]

The Islamic commercial law is based on the same philosophy of brotherhood in all its commercial transactions. This very philosophy and the cooperative spirit has been translated into practical modes of Islamic financial transactions such as *Mushārakah, Diminishing Mushārakah, Mudārabah, Musāsqat, Muzāraat,* etc. All of these modes reflect, directly or indirectly, the principle of cooperation. For example, *Mudārabha* provides a legal ground to an investor, who has wealth but no business acumen, and an entrepreneur, who has business sense but no capital, to enter into cooperative arrangements which would benefit both, whereas, individually, neither could put this wealth or skill into beneficial use. Similarly, *Mushārakah* is a participatory mode of financing wherein the investors pool their resources, expertise and efforts and share the profits (as pre-determined in the *Mushārakah* agreement) and losses of the business undertaking (in the ratio of participants' investment)

"*Sharikāt*" is an Arabic word literally meaning mixing or *Ikhtilāt*. "Most of the partners are transgressing on each other."[481] *Sharikāt,* in Islamic jurisprudence, is used for describing a contract of partnership. It is defined as, "a contract between two or more persons for

---

[480]The vanguard (of Islam)- the first of those who forsook (their homes) and of those who gave them aid, and (also) those who follow them in (all) good deeds,- well- pleased is Allah with them, as are they with Him: for them hath He prepared gardens under which rivers flow, to dwell therein for ever: that is the supreme felicity(*Qur'ān* 9:100).Abdullah Yūsuf Alī,http://www.islam101.com/quran/yusufAli/index.htm(accessed March 5, 2012).

[481]*Qur'ān*, 38:24.

participation in capital and its profit[482] The other prominent schools of thought (e.g. *Maliki*, *Shafa'ī* and *Hanbalī)* define *Sharikāt* on the same way, and therefore, there is no need of their discussion separately. The definition given by *Hanafi* school of thought is more elaborate as it covers the essential components of partnership (i.e. parties, agreement, capital investment, sharing of the profit) and will, therefore, be used in this work.

The *Sharikāt* can be divided into three classes i.e. *Sharikat-ul-Ibāha* (common sharing of things),[483] *Sharikat-ul-Milk* (co-ownership)[484] and *Sharikat-ul-'Aqd* (partnership through contract). This classification is very exhaustive in nature and covers all related areas of partnership in Islamic law. However, the present work is mainly related to the last one i.e. *Sharikat-ul-'Aqd*, and hence, more focus will be made over it.

According to *Majallah al-Ahkām al-'Adliyah, "*It is a partnership which comes into being as a result of agreement between two or more persons in order to share profit".[485] This important kind of *Sharikāt* is further divided into three classes by the Hanafī school of thought i.e. *Sharikat-ul Amwāl, Sharikat-ul-Amal* and *Sharikat-ul-Wajūh.*[486] However, *Sharikat-ul-Amwāl* is more practicable and workable as for as the present mechanism of banking sector is concerned.

---

[482]Ibn 'Ābidīn, *Raddul al-Muhtār* , vol.6, p-208.

[483]"It is the common right of the people in ownership by acquisition or gathering of items that are permissible and not originally owned by any one" This means that if the item is not permissible in *Shari'ah*, or when it is acquired by someone else, then such common right cannot be exercised. Most classical jurists like Imām Sarakhs ī and Imām Kasanī, etc do not discuss the concept of *Sharikat-ul-Ibāha* in their works…………

[484]According to Hanfī jurist Imām Saraksī, "It is the partnership between two persons in a property"……. Sarakhsī, *Al-Mabsūt*, vol.11.p.142;Ibn-'Ābidin defines the term more comprehensively as, "It is an ownership by a number of persons of any ascertained property or*Dayn* (debt not ascertained by weight or measure or other means) arising through inheritance or through exchange (bay) or through other means"…Ibn 'Ābidīn, *Raddul al-Muhtār*, vol.11/4, p-301.

[485]Commission of Ottoman Jurists (1867-1877), *Majallah al-Ahkām al-'Adliyah* (Constantinople, 1305 AH), Article 1329.

[486]Sharikat-ul-Amwâl is a contract whereby two or more persons invest certain capital into a commercial enterprise. This is considered the ideal form of Sharikat-ul-'Aqd.Sharikat-ul-'Amal is a contract involving two or more persons who provide services to their customer and the fee charged for the services, is distributed among them according to the agreed ratio. Sharikat-ul-Wajûh is a contract whereby two or more persons use their good-will, their credit worthiness and their contacts for promoting the business without contributing to the monetary capital….. Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.32.

Like other commercial transactions, there are some governing rules prescribed by *Sharī'ah* for *Mushārakah.* All these rules must be followed both in letter and spirit in order to achieve the intended results envisaged by Islamic law from the application of such mode. These rules are numerous in nature; however, for the purpose of succinctness the most important will be discussed in the coming lines.

Firstly, as *Mushārakah* is a contract, and therefore, all rules and regulations of a valid contract will be applicable. It means that there must be proper offer and acceptance, legal obligation, free consent, capacity of the parties, lawful object, possibility of performance etc. Secondly, as the main purpose of *Mushārakah* arrangement is to earn profit, therefore, the issue of its distribution will be settled in the beginning of the contract.[487] It is pertinent to mention that the profit to be divided between the shareholders must be related to the actual profit accrued by the business and its sharing must be pre-determined in clear terms. For example one-half (1/2), one-third (1/3), one-fourth (1/4) or a given percentage of actual percentage of the profit, e.g. 10% or 20%, etc.[488] In addition, it is not allowed to determine a fixed lump sum amount for any or all partners nor it should related to the amount of capital invested by each party.[489] Some of the financial institutions provide a fixed amount of profit for their customer in case of *Mushārakah,* but it should be subjected to final settlement at the end of the banking year.[490] Fourthly,[491] according to *Hanafī* School of thought, it is lawful that the capital of each partner may be equal and yet the profit be shared unequally.[492] In their view the profit share in the contract of *Mushārakah* is related to the agreement, not to the capital.[493] However, this school considers this

---

[487]Burhānu Din abī al Hasan Ali IbnAbī Bakar al Marghinānī ,*Al Hidāyah Sharh Bidāyat ul Mubtadī*,(Karachi,Pakistan ,Maktabatul Bushra ,Second Edition 2008),vol.4.p.378.

[488]Muhammad Taqi Usmani, *An Introduction to Islamic Finance* p.36.

[489] Mohammad Nejatullah Siddiqi, *Partnership and Profit-Sharing in Islamic Law*, (Leicester,UK The Islamic Foundation, 1985), p-22-23.

[490] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.386.

[491]The issue is comprehensively discussed in another article with minute Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, Mushârakah—A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan, Arab Law Quarterly,Volume 28, Issue 1, 2014,pp.: 1–39 (39).

[492]Wahbah-al-Zuhaylī, *Al-Fiqh-al-islāmī –Wa-Adilatuhū*, vol.5.p.3901.

[493]Marghinānī ,*Al Hidāyah Sharh Bidāyat ul Mubtadī*,vol.4.p.378.

rule as applicable in normal situations.[494] However, it recognizes that in a special situation, where a partner explicitly agrees to never participate in the management of the business (a sleeping partner), that their share of profit cannot be more than the ratio of their investment.[495] Fifthly, the contract can come to an end by various means i.e. death of a party or lost of legal capacity, issuing of notice by any party for the termination of the contract, completion of the time period prescribed in the contract, destruction of the subject matter of the contract etc.

5.3.2.2 *Mushārakah* as a Financing Tool for Agriculture

Sharī'ah, strictly forbids Muslims to secure loans on an interest basis from any formal or informal institutions. Hence, Muslim farmers must resort to identifying other sources of financing recognized by Islamic commercial law in general, and by the Islamic financial system in particular. The classical Muslim jurists have attributed much importance and have examined these alternative funding sources in great detail. Among these, *Mushārakah* (participatory mode of finance) is the most important. Compared to the others, the Hanafī school of thought has carried out an extensive study on this mode. One of the great Hanafī Jurists, Imām Sarakhsī cited as an authority, devoted a major portion of his work to this Islamic mode of financing and elaborated on it in his book titled Al-Mabsūt.

Muslim jurists, particularly the classical ones, developed the concept of *Mushārakah* in minute detail. However, they did not discuss application of *Mushārakah* to the agricultural sector both for crop and non-crop activities in detail; owing to the fact that they were dwellers of such lands which were not suitable for agricultural activities. However, they did not ignore the agriculture sector in absolute terms. They discussed the concept of *Muzār'ah*, and *Musāqah* in some detail.[496] However, their discussion of both these concepts was made for local levels rather than institutional. Nevertheless, in fact such discussion paved a way for the contemporary scholars to apply both these concepts at institutional level with more focus and accuracy.

---

[494]Muhammad Taqi Usmani, An *Introduction to Islamic Finance*, p.37.
[495]Wahbah-al-Zuhaylī, *Al-Fiqh-al-islāmī –Wa-Adilatuhū*, vol.5.p.3901.
[496]See for example works of Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, Kitab-al-Sharika, vol.2, p.389;Kāsānī, *Bādā'i'al-Sanā'i'*, vol.6,p.280;Marghinānī ,*Al Hidāyah Sharh Bidāyat ul Mubtadī*,vol.7,p.99 etc.

Some of the contemporary scholars talk about *Mushārakah* and its effective application for the development of the agricultural sector. They discuss comprehensively how such commercial transactions can be applied with true spirit, aims and objectives. They have developed various concepts for agricultural projects including methods for the distribution of profit, sharing of loss, risk minimization in agricultural finance and the monitoring and supervision of agricultural projects. With a special focus on local farming in rural areas, they have developed various methods for the minimization of cost etc.[497]. These researchers include Kazim Sadr,[498] Badawi B. Osman,[499] Ali Yasseri,[500] Hossein Mahdavi Najmabadi,[501] Mahmoud A.Gulaid,[502] Ausaf Ahmad,[503] Ali Abdalla Ali, etc.[504] However, the work of all these does not deal with the concept of *Mushārakah* in detail. Some of the above mentioned academic works are purely related to a particular type of *Mushārakah* i.e. Diminishing *Mushārakah,* while others are related to Islamic agricultural finance as a whole. The research of Ali Abdalla Ali provides valuable methods for financing agriculture particularly that of rural areas. However, his work is solely related to Sudan.

---

[497] See for example the work of Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, *Mushârakah—A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Arab Law Quarterly,vol 28, issue 1, 2014,pp.: 1–39 (39).

[498] See for example his work :Kazim Sadr ,*The Role of Musharakah Financing in the Agricultural Bank of Iran*,Arab Law Quarterly, Vol. 14, No. 3 (1999), pp. 245-256 .http://www.jstor.org/stable/3382082 (accessed June7th,2012).

[499] See for example his work: Badawi B. Osman,*The Experience of Sudanes Islamic Banks in Partnership (Musharakah) Financing as a Tool for Rural Development among Small Farmers in Sudan* , Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 221-230 .http://www.jstor.org/stable/3382080 (accessed June7th,2012).

[500] See for example his work:Ali Yasseri, *The Experience of the Islamic Republic of Iran in Musharakah Financing*, Arab Law Quarterly, Vol. 14, No. 3 (1999), pp. 231-24 .http://www.jstor.org/stable/3382081 (accessed July 7,2012)

[501] See for example his work:Hossein Mahdavi Najmabadi, Proposal *for a Modified Model of Musharakah Financing, with Emphasis on Iran*", Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 282-301 http://www.jstor.org/stable/3382085. (accessed November 7,2012).

[502] See for example his work:*Mahmoud A.Gulaid, Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34.

[503] See for example his work: Ausaf Ahmad, *Contemporary Practices of Islamic Financing Techniques*, Islamic Research and Training Institute, Islamic Development Bank, Jeddah, Saudi Arabia,Research Paper No. 20.

[504] Ali Abdallah Ali, is Professor of Economics, College of Business Studies, Sudan University of Science and Technology, Khartoum, Sudan. He is also Editor, www.sudanfinancialtimes.com, See for example his work Microfinance or Musharaka finance in Sudan; banking on the un-bankable, Sudan Financial Times . November 15,2007.

Mushārakah is the most suitable mode of Islamic finance for agricultural sector, both crop and non-crop activities.[505] However, its role is more dominant in the crop sector and, hence, can be used for the development of local farming, particularly in rural areas of the country. Nearly 62% of the country's population resides in rural areas, and are either directly or indirectly linked with agriculture as their livelihood.[506] Additionally, these areas remain mostly ignored in terms of financing by the Islamic banks and other Islamic financial institutions. The people of such areas have small land holdings that are barely enough to sustain them at a subsistence level.

It is pertinent to mention that the concepts of *Muzār'ah*[507] and *Musāqah,*[508] being typical types of *Mushārakah*, can be applied to the contemporary Islamic agricultural finance. Both of these concepts can be used by the Islamic banks and other Islamic financial institutions for gardening and watering of large fields. Their application is more effective in the urban areas as compared to rural areas; as the latter mostly exist in the hilly areas. The literature related to rules and regulations of both should be followed very strictly, in both letter and spirit, in order to get the required results envisaged by Islamic finance through their application. Unfortunately Islamic banks and other Islamic financial institutions have completely ignored both these concepts in financing agriculture.[509]

---

[505]Agriculture sector can be classified into different categories i.e. local farming, fish farming, poultry farming, horticulture, live stock etc. However, in this work concentration is given to the application of Mushārakah related to local farming because of its more prevailing nature in the subcontinent.

[506]Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan Ministry of Finance, Chapt.2,p.13 http://www.finance.gov.pk/(accessed Feb. 6, 2012).

[507]*Muzār'ah,* or crop sharing, is a partnership entered into for agricultural purposes. Technically it can be defines , as "a contract for cultivation of land in return for part of the produce in accordance with the conditions stipulated by law"(Marghinānī ,*Al Hidāyah Sharh Bidāyat ul Mubtadī*,vol.7,p.99). The Hanbali School defines it as "it is a contract where a land is handed over by one party to another for cultivation in return for part of the produce"(Abdullah ibnī Qudāma al Muqadasī,*Al-Kafī*, vol.2, p.298).

[508]Imām Kāsānī, a renowned Hanfī jurist, defined *Musāqah* as "a contract of work for part of the produce along with the condition of validity"(Kāsānī, *Bādā'i'al-Sanā'i'*,vol.6,p.280). A more comprehensive definition is given by Ibn Qudāma, "It is a contract for the caring of trees for part of their fruits"(Abdullah ibnī Qudāma al Muqadasī,*Al-Kafī*,vol.2,p.289). Some other researcher defines it as "A contract whereby one party concludes a deal with another, requiring the latter to look after the fruit trees belonging to the former for an agreed share of the total produce".

[509]Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, *Mushârakah—A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan,*Arab Law Quarterly,vol.28, issue 1, 2014,pp.: 1–39 (39)

5.5.2.3 Needs of Farmers

Before the discussion of various models on *Mushārakah* basis, it is appropriate to know about basic needs of farmers, more importantly those which can be fulfilled through this mode of Islamic finance. These needs include the following.

1. Farmers are always in need of funds to purchase agricultural inputs like seeds, fertilizer and pesticides. They also require means to bring their produce to the market so that the portion of their profits, normally used to pay others to transport their goods, may also accrue to them. These needs are usually required in local farming particularly that which exists in rural parts of the country.
2. Farmers are also in need of heavy agricultural machinery and equipments (see figure No.18). These equipments and machineries, which are numerous and expensive in nature, required by almost all farmers in their fields. While having meager economic conditions, the lower and middle class farmers are not in a position to purchase such equipment for themselves (see figure No.19).The machinery used by the farmers can be divided into various groups, based on their purposes and functions. These include traction and power (like tractor), soil cultivation (like cultivator, cultipacker, chisel plow, harrow, spike harrow, plow, spading machine, stone removal implement, subsoiler, rotator, etc), planting equipments (like broad cast seeder , planter, plastic mulch layer , potato planter, seed drill, air seeder, transplanted, etc.), fertilizer and pest control (like fertilizer spreader, terragator, liquid manure, manure spreader, sprayers, etc.), irrigation (center pivot irrigation, drip irrigation, hydroponics, etc.), produce sorter (like weight sorter, color sorter, blemish sorter, diameter sorter, shape sorter, etc.), harvesting (baler, beet harvester, beet cleaner loader, bean harvester, cane harvester, cart carrot harvester, chase bin, combine harvester, corn harvester, cotton picker , cradle, gleaner, grain cleaner, grain dryer, grape harvester, gravity vagon, potato spinner, potato harvester, rake, reaper, reaper, binder, rice buller, sickle, silage trailer, sugarcane harvester, swather, thresher, tractor, etc.), hay making (like bale mover, bale wrapper, baler and big baler, conditioner, hay rake, haytedder, mower, bale lifter, loading (like backhoe loader, front end

loader, skid steer loader, etc.) milking (like bulk tank , milking machines, milking pipeline, etc.), obsolete farm machinery (like stationary steam engine, portable engine, traction engine, reaper binder, flail, hog oiler, reaper, winnowing machine, threshing machine, drag harrow, etc.) and etc.

3. Farmers are always in need of transport facilities in order to carry their products to the local market on time. This facility may include tractors, refrigeration vans, farm cooling tanks, motorcycles for milkmen, small pickups, mini trucks and chiller carriers, etc.[510] Effective transportation plays a vital role in the development of the agricultural sector.

4. A considerable number of farmers hold the land units of less than 12.5 acres, which is barely enough for providing subsistence standards of living.

Table. Land units held by farmers

Categories of Farmers	No. of Farms		Farm Area	
	Million	Percent	Total (million acre)	Percent
Marginal farms up to 5 acre	2.41	58.64	5.31	28.92
Small farms (5 – 12.5 acre)	1.70	41.36	13.05	71.08
Total small farms	4.11	100.00	18.36	100.00

Source: Agriculture census organization, 1990

Table 11: Land units held by farmers

5.3.2.4 Solution of the Farmers' Problems through *Mushārakah* Based Models

The above table illustrates that except for a few big landlords, the average farmers generally remain poor as they hold a very small piece of land for cultivation of agricultural crops .This actuality puts them in the back lines of poverty and hence they always face financial problems.

[510] *Guidelines on Islamic Finance for Agriculture*, Islamic Banking Department, State Bank of Pakistan, p.5. http:// www.sbp.org.pk/guidelines/IslamicAgriculture/Guidelines-Islamic-Financing-Agriculture-01-09-2008.pdf(accessed: 28th February , 2014).

Therefore, some arrangements must be made under the contract of *Mushārakah* in such a way to provide them land for cultivation purposes which would really increase their agricultural production and consequently their income and life standard.

All these requirements can be fulfilled through various models, structured on the basis of *Mushārakah*. For instance, requirements mentioned in category No.1 can be fulfilled where Islamic banks may enter into an arrangement, by creating contractual obligations, with the farmers whereby an Islamic bank provides the required funds for the agricultural inputs and the farmer contributes land, labor and management from sowing to harvesting the crop(s). The profits of the joint venture, which can be called, "We Cultivate Together" can be shared by the Islamic bank and the farmer under a predetermined ratio. The risks normally associated with agriculture are drought, floods, hail, earthquakes, pests attack, mudslides and a multitude of other mishaps.[511] Ironically, these risks are not common in other sectors.[512] All these risks may be mitigated under *Takāful* (Islamic insurance) cover. Putting together all the factors of production for a gainful business pursuit will create a form of *Mushārakah* between an Islamic bank and a farmer. As discussed earlier, the Islamic bank may assume the role of a sleeping partner thus confining its share of profit, as well as the loss, to its investment. The farmer, on the other hand, will manage the entire production process and, as such, will be entitled to claim managerial costs (*ujrat-ul-'Amal*)[513] as the deductible business expenses before arriving at the distributable profit from the venture. It must be borne in mind that an Islamic bank, under such an arrangement, will not be a lender of the money to a farmer but an active or sleeping partner who is providing all or

---

[511]Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50.

[512]Waiter Schaefer – Kehnert and Jhon D.Von Piodike, *Agricultural Credit Policy in Developing Countries*, (World Bank Reprint Series: Number 280, January. 1982), p.17.

[513] According to the Hanāfi school of though a person is entitled to profit because of Māll (capital), or 'Amal (work) or Damān (liability).So it is permissible that a party to the contract of Mushārakah may get more profit irrespective of his capital share as he may contribute more in the shape of work as compared to other parties .This is based on the Hadith of the Holy Prophet (SAW) "The profit will be distributed according to the agreement and lost will be borne according to the capital".(Wahbah-al-Zuhaylī, *Al-Fiqh-al-islāmī –Wa-Adilatuhū*,vol.5.p.3901).

most of the agricultural inputs (e.g. tools, seed, fertilizer, pesticides, irrigation etc.) and shares the profit or loss of the partnership. The farmer, therefore, will not be required to offer any collaterals[514] (e.g. guarantees, pledging of assets or mortgage of properties) to Islamic banks, which are normally required by conventional banks against their lending at a considerable cost of creating such collaterals. The following diagram may explain the theory in the best way:

Model 1

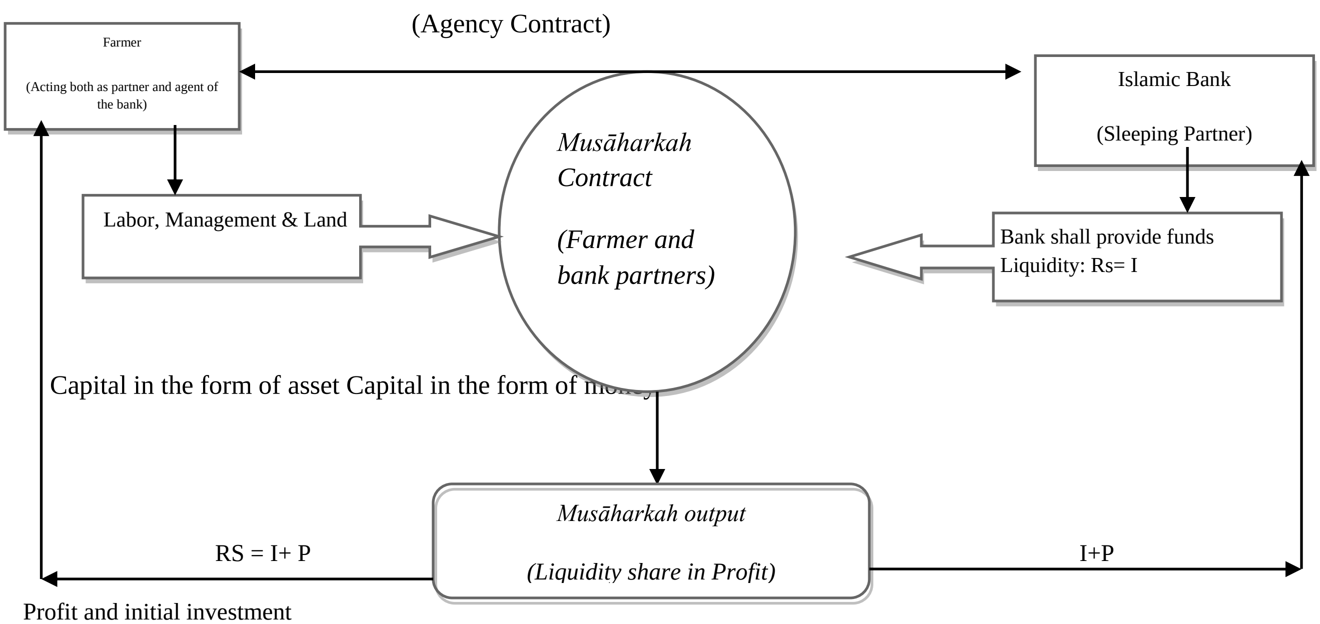


Figure 12: ***Mushārakah*** based model 1

The requirements which are mentioned under the category No.2 and No.3 can be fulfilled through a variety of models based on a typical and contemporary type of *Mushārakah* known as

---

[514] The concept of Rahn (pledging of asset) is applicable to loan and sale transactions.it can also be applied for the securing of Ujrah (rent),Mahr(dower) ... see for further details (Ibn Qudāmah al-Maqdisī, *Al-Kafī*, vol.2,p.128);The concept of Kafālah is applicable for any liability in general ,while the concept of Hawālah(assigning of debt) is only applicable in case of loan transaction. (Abū al Walīd Muhammad ibn Ahmad Ibn Rushd, *Bidāyt-al- Mujtahid Wa Nehāyat-al- Muqtasid,* vol. 2, pp.525-536).

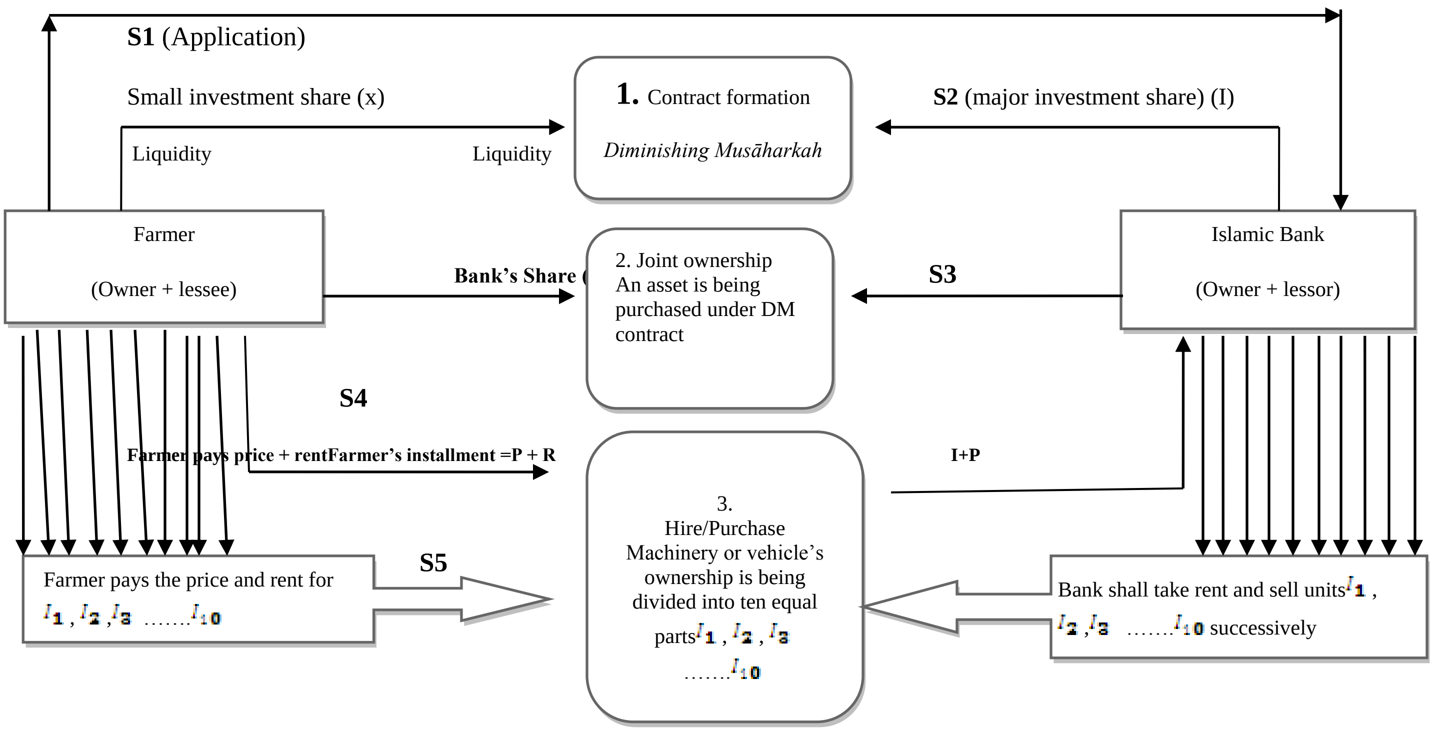
the Diminishing *Mushārakah*.[515] While following this arrangement, the Islamic banks and other Islamic financial institutions use Diminishing *Mushārakah* for the purchase of heavy agricultural machinery and transport facility which includes purchase of tractors, refrigeration vans, farm cooling tanks, and transport vehicles, etc. [516] Under this model, the Islamic bank and the farmer acquire the vehicles collectively and become co-owners of the asset. This arrangement has been accepted by majority of farmers (see figure No.20). Once this relationship is time-honored, the farmer will take the share of the Islamic bank on a rental basis. This understanding has also been accepted by majority of farmers (respondents) (see figure No.21). The share of the Islamic bank will be divided into small units and the farmer will purchase these units periodically. It is sensible for Islamic banks and other Islamic financial institutions to divide their shares comparatively in small units than they do in their normal business with ordinary customers. A special relaxation, therefore, will be provided to farmers in their payment structure and mechanism; owing to the fact of their meager economic condition. While doing so, such financial institutions will also put their share in the development of agricultural sector; which is always considered a national sacred cause. This process will be continued until the share of the farmer increases to full ownership of the vehicle. The division of bank's share in various units and their subsequent sale has been appreciated by majority of farmers (see figure No.22).

---

[515] Some of the scholars trace back the legality of D.Mushārakah in the HolyQurān "*"If the man or woman whose inheritance is in question, has left neither ascendants nor descendants, but has left a brother or a sister, each one of the two gets a sixth; but if more than two, they share in a third; after payment of legacies and debts; so that no loss is caused (to any one). Thus it is ordained by Allah. Allah is All-knowing, Most Forbearing*".(*Qur'ān* 4: 12). It is is defined in AAOIFI " A form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title of the equity is completely transferred to him"…….Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010, Bahrain, English Version,,Rule.5/1,p.214, http://www.aaoifi.com (accessed December 25, 2011)……
It is totally a new concept to the Islamic financial system envisaged by the contemporary scholars, i.e. Mulana Mufti Muhammad Taqi Usmani,Wahbā-al-Zuhaylī,Adullah bin Suliman-al-Manee, Abdurrehman bin Sālih, Al-Sādiq Muhammad-al-Ameen, Ajeel Jasim , Yousf Muhammad, etc…….(See for the detailed rules of Diminishing Mushārakah Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010, Bahrain, English version, Sharī'ahStandard.12, Al-Sharikha wa Al-Sharikatul-Haditha, p.205 and onward.)….The International Fiqh Academy of OIC in its 15th session has made a detailed discussion on this mode of Islamic finance where the *Shari`ah* scholars have discussed its fundamental characteristics"………see for example International Fiqh Academy of the Organization of Islamic Conference, 2004, 15
Th Session, Resolutions of Musharakah Mutanaqisah and its Sharī'ah
Principles, http://www.fiqhacademy.org.sa/. (accessed 15th December, 2011).
[516] *Guidelines on Islamic Agricultural Finane*, Agricultural Credit Department Islamic Banking Department,State Bank of Pakistan,p.5.http://www.sbp.org.pk/guidelines/IslamicAgriculture/Guidelines-Islamic-Financing-Agriculture-01-09-2008.pdf(accessed December 27, 2011).

All risks and liabilities related to the ownership will be divided by the parties according to their share in the asset. Through mutual agreement, however, they can divide these liabilities otherwise. This contract of Diminishing *Mushārakah* is very useful because most farmers are very poor and these assets, while very expensive, are essential for their livelihood. Since they do not have the necessary resources to purchase these assets, Diminishing *Mushārakah* can be a viable option.[517] Majority of farmers have the same opinion. The following model can be developed in light of the theory mentioned above.

Model 2: Diminishing Musāharkah based mode of financing (provision of heavy agricultural machinery and transport financing)



---

517 The idea has been taken from the work of Lutfullah Saqib,Kellie W. Roberts; Mueen A. Zafar, Khurram Khan and Aliya Zafar regarding the concept of Mushārakahnd and its Application to the Agricultural Sector in Pakistan, published in a well renowned journal on Islamic research i.e. Arab Law Quarterly

Figure 13: Model 2 Diminishing *Musāharkah* based mode of financing (provision of heavy agricultural machinery and transport financing)

The requirement which is mentioned under the category No.4 can be fulfilled through a variety of models based on a typical type of *Mushārakah* known as *Muzār'ah*. This peculiar type of contract can be applied for the solution of the problem in four different ways. Firstly, by entering into a legal agreement where an Islamic bank/Islamic financial institution provides the land and other physical factors of production while a farmer contributes the labor.[518] In this case the farmer is solely entitled to a particular portion in lands' production because of his labor. Secondly, a situation where the Islamic bank provides only land while the farmer provides basic agricultural inputs and labor. In this case, he will be entitled to more share in yield as compared to the previous one for being a major contributor in the whole course of business. Nevertheless, the question arises that how the Islamic bank will acquire the land in order to hand it over to the farmer. There are two available possibilities for financial institutions to solve this problem. For instance, they can obtain authorization to occupy or use any piece of agricultural land (a bank may acquire such authorization as a result of another financing deal where the land is hypothecated or acquired on mortgage).[519] Similarly, they can also acquire lands on long-term lease from a landlord and rent these out to the farmers under *Muzār'ah*. Thirdly, a three party *Muzār'ah* can be concluded where one party (the Islamic bank) provides land, the second (bank) provides a combination of required physical inputs, and the farmer provides labor. This method is very useful for large pieces of land, which are usually owned by the upper class of farmers. The following models can illustrate the previous discussion in a better way.

---

[518]Magda Ismail Abdil Muhsin, *The Practice of Islamic Banking System in Sudan*,Jounal of Economic Cooperation 26 (4) 2005, pp .27-50. http://www.sesric.org/jecd/jecd_articles/ART05070102-2.pdf (accessed March 10 ,2012).
[519]Manzer Khaif and M.Faheem Khan,*Short Term Financing of Commodity Production in Islamic Perspective* , ,Paper had to be presented to the seventh annual meeting of the expert of Islamic banking ,Kualalumpur,spring 1992. http://monzer.kahf.com/papers.pdf (accessed March 8 ,2012).

***Muzār'ah* based models:**
Model No: 1

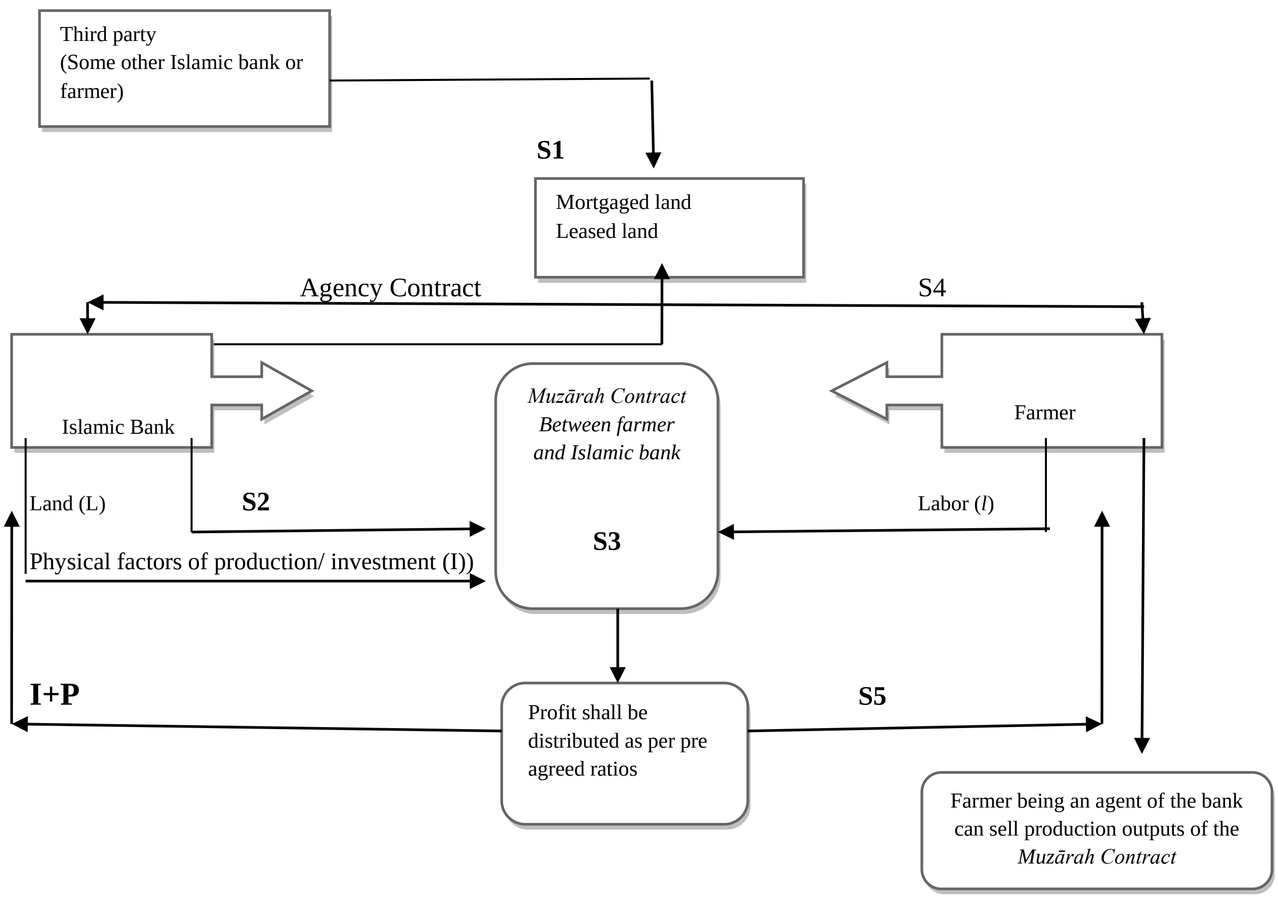


Figure 14: *Muzār'ah* based models 1

Muzār‘ah based models:
Model No: 2

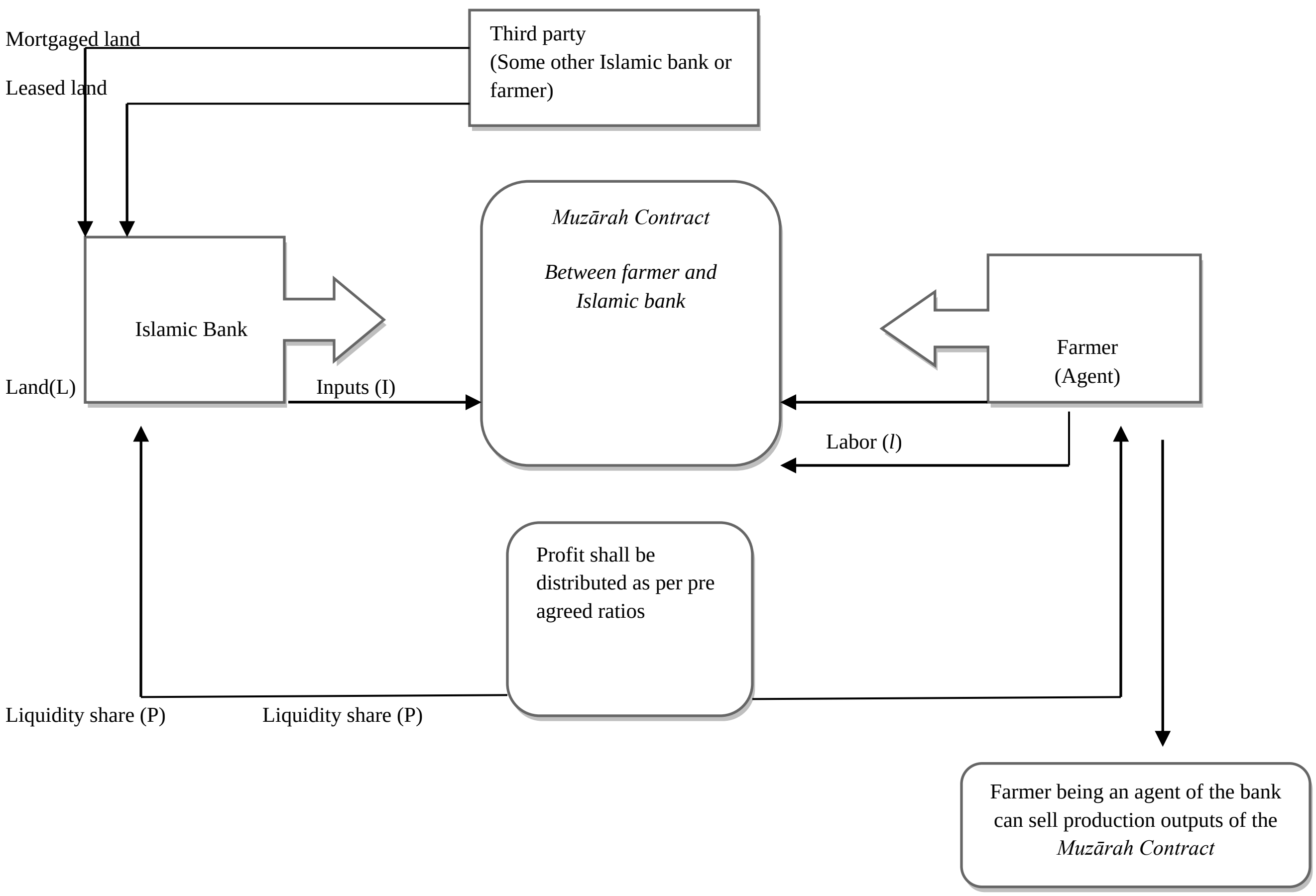


Figure 15: *Muzār‘ah* based models 2

***Muzār'ah* based models:**
Model No: 3

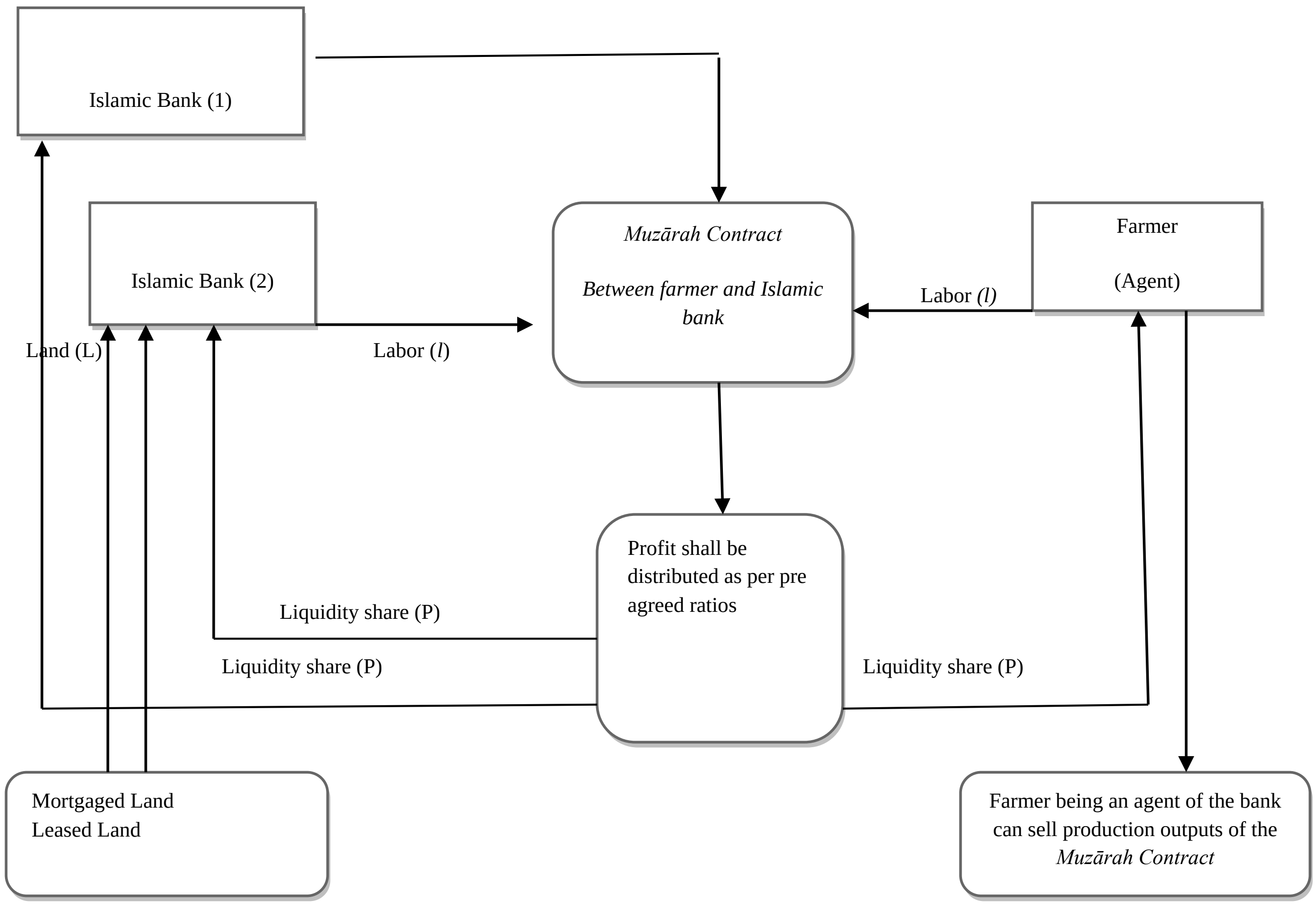


Figure 16: *Muzār'ah* based model 3

5.3.2.5 Non Acceptance of *Muzār'ah* Based Models in the Farming Community

It is a matter of fact that *Muzār'ah* is a peculiar type of *Mushārakah* envisaged by Islamic commercial law for the development of agriculture sector. The lower class of farmers, particularly those who have no agricultural land, can take benefit from this type of arrangement. But ironically the respondents (majority of whom belong to the lower class) do not approve any

one of the *Muzār'ah* based model. The following graphical presentation is drawn from the response of the farmers

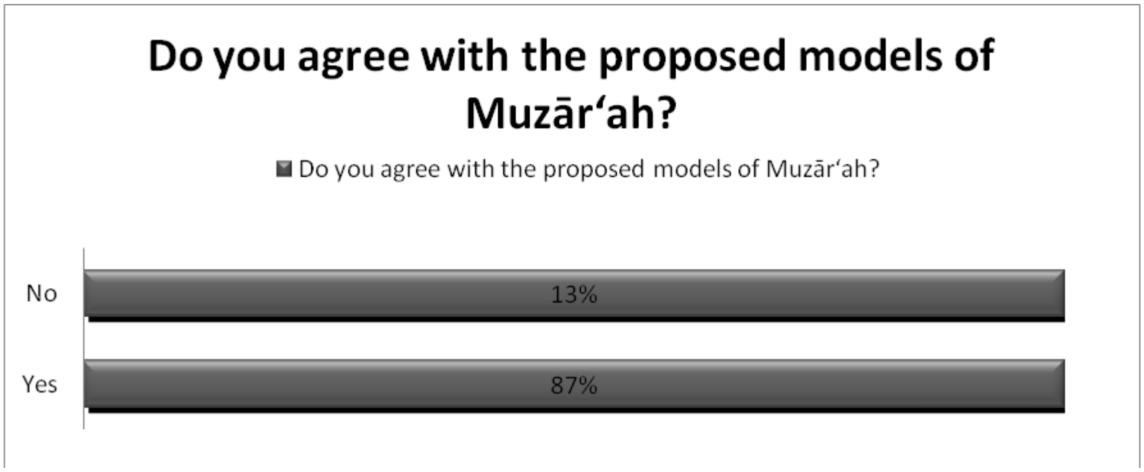


Figure 17: Do you agree with the proposed models of Muzār'ah

The graphical presentation indicates that 87% of the respondents (from the group) are against the proposed models of *Muzār'ah.* There are some reasons for this negative perception of the farmers. Firstly, the proposed *Muzār'ah* based models are very complex in nature, and therefore, difficult for the illiterate farmers to apprehend its structure, rules and regulations. Secondly, the transaction is more suitable for large piece of land while majority of the respondents were either having small piece of land or having no land at all. Thirdly, the *Muzār'ah* is basically structured for individuals and, therefore, its institutionalization goes against its nature. The financial institutions, owing to the fact of these reasons, do no opt *Muzār'ah* based financing.

5.3.2.6 *Mushārakah* Models on Trail

A focused group survey was conducted for the purpose to check the viability and practicability of the proposed *Mushārakah* based model for agriculture sector, particularly local farming. The farmers were asked various questions related to the whole mechanism of the model. The following response had been received.

- The farmers are always in need of heavy agricultural machinery for various purposes. This requirement of heavy machinery is also confirmed by 95% of the respondents as shown in the following graph.

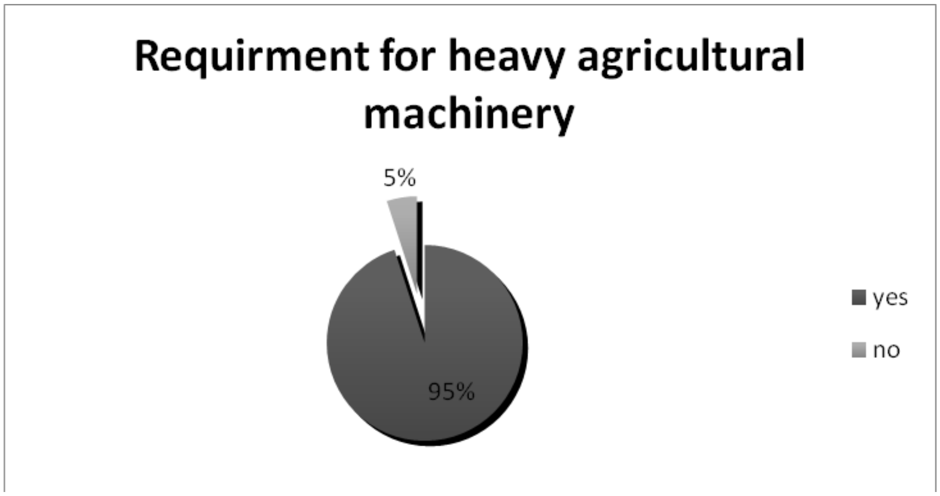


Figure 18: Requirement for heavy agriculture machinery

- The lower and middle class (lower middle class) farmers are not in a position to purchase heavy agricultural machinery. This fact has been established through the collected data where such farmers were asked regarding their financial capacity to buy the required agricultural machinery.

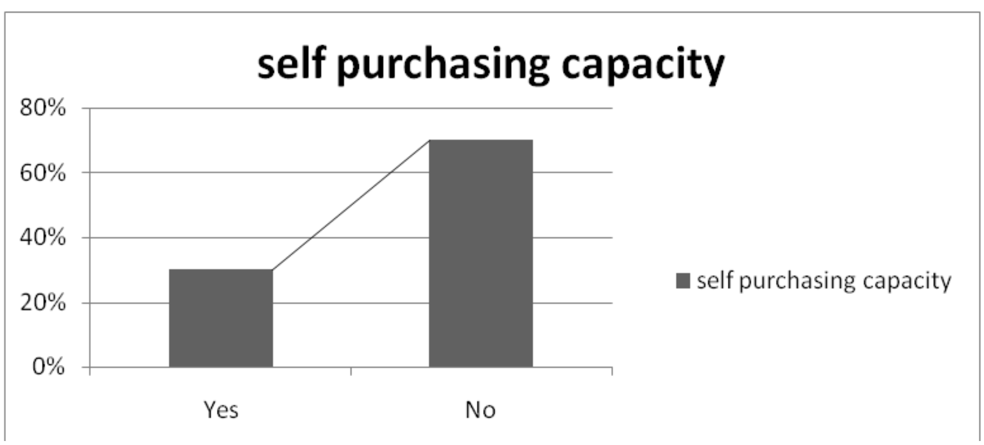


Figure 19: Self purchasing capacity

The graphical presentation clearly indicates that 70% of the respondents from the groups have confirmed their financial inability to purchase agricultural machinery. It means that Islamic banks and other Islamic financial institutions can target this potential area in their financing policies.

- Under Diminishing *Mushārakah* model, the Islamic bank and the farmer acquire the vehicles collectively and become co-owners of the asset. This arrangement has been accepted by majority of farmers as shown in the following paragraph, designed from the collected data

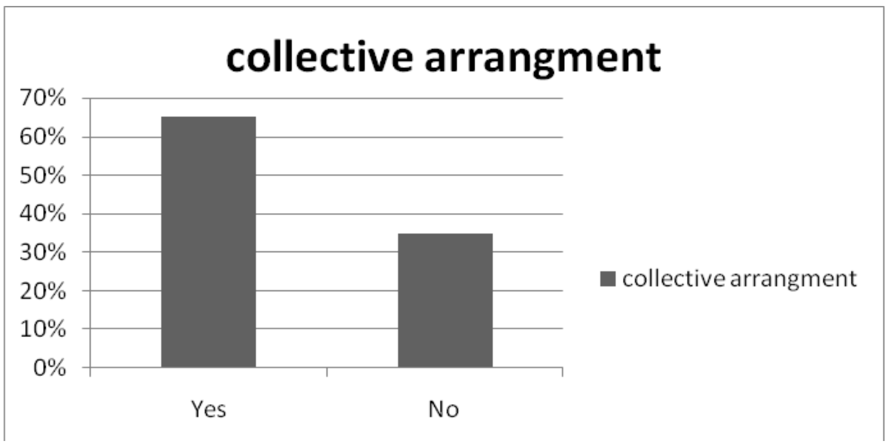


Figure 20: Collective arrangement

In the above graphical presentation 65% farmers are agree to purchase the agricultural machinery jointly with the financial institutions through the arrangement of Diminishing *Mushārakah*. This positive response shows the viability of this arrangement for the development of agricultural sector.

- Under the Diminishing *Mushārakah* the farmer will take share of the Islamic bank on a rental basis. This arrangement has been accepted majority of farmers when they were asked about the same issue. The following graphical presentation can be presented as evidence.

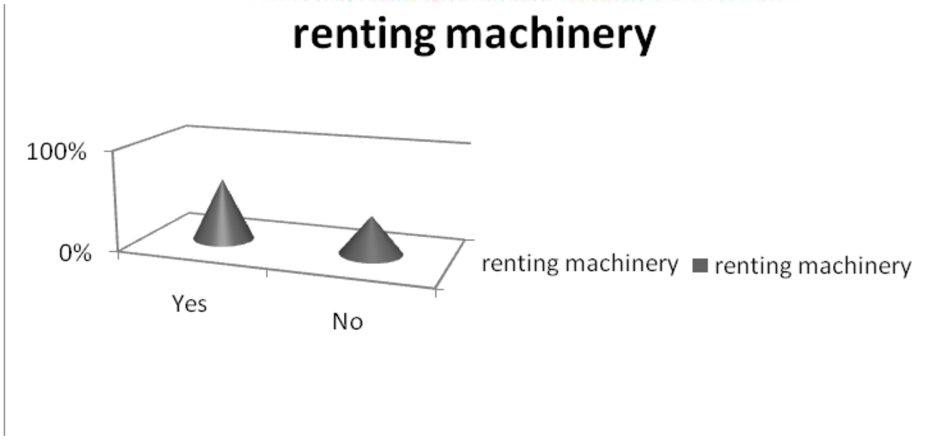


Figure 21: Renting machinery

- The division of bank's share in various units and their subsequent sale (in Diminishing *Mushārakah*) has been appreciated by majority of farmers from the various groups. The following graphical presentation can explain their view in a better way.

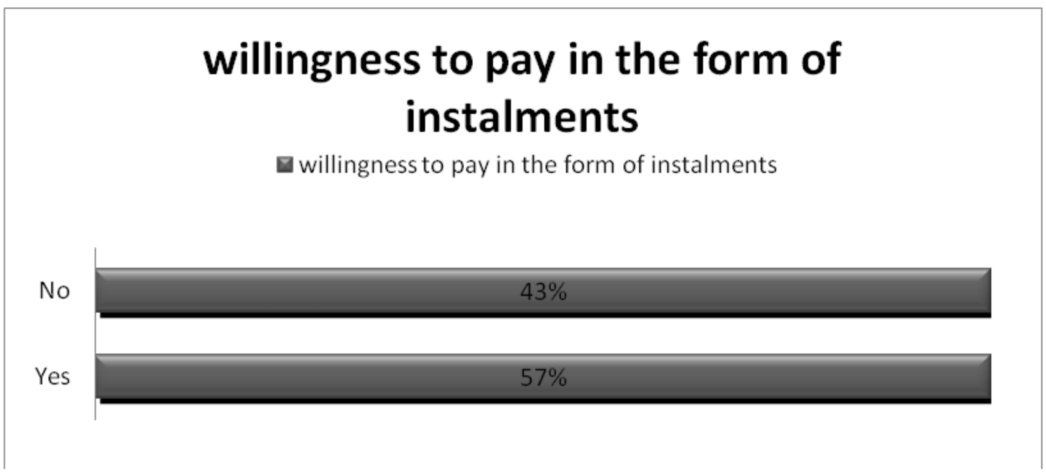


Figure 22: Willingness to pay in the form of installments

The graphical presentation shows that 57% of the respondents are willing to pay price of the agricultural machinery/commodity in installments rather than on spot. This fact illustrates appropriateness of the Diminishing *Mushārakah* for financing agriculture.

5.3.2.7 Conclusion

While summarizing the whole discussion it can be concluded that if the Islamic banks and other Islamic financial institutions want to obtain the required results from *Mushārakah,*

alterations need to be made in the existing structure employed by the Islamic banks. The existing procedure described by *Sharī ʻah* Standards (AAOIFI) is very complex in nature and should be replaced with a simple procedure understandable by the farmers who desperately need the financing but may find it difficult to understand the complicated process currently in place.[520] In addition, the Islamic banks must participate in the agri-business, though such participation may be indirect in nature through the appointment of an agent. Moreover, all *Mushārakah* based models should be developed in such a way to serve and benefit the lower and middle class of farmers; who more deserve to be assisted financially. In other words, local farming will be concentrated more in terms of financing than other sectors of agriculture like livestock, dairy farming, fish farming, horticulture, poultry farming etc. The financial institutions need to earn less profit from farmers as compared to other general customers in concert with the basic philosophies of cooperation and development of society, aimed by the Islamic financial system.[521] If all the above suggestions are followed by Islamic banks and other Islamic financial institutions, then all *Mushārakah's* based models can be proved very vital for the development of agricultural sector. This fact has been confirmed by the farmers while giving the answer whether they think *Mushārakah's* based models will benefit agricultural sector as a whole. Their answers are built in the following graphical presentation.

---

[520]Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, *Mushârakah—A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Arab Law Quarterly,vol 28, issue 1, 2014,pp.: 1–39 (39).

[521]Social welfare and support: This objective of *Sharī`ah*has been approved by a well renowned Muslim scholar Yusuf al-Qardawi… (Mohammad Hashim Kamali,*Maqasid al Shariah: The Objectives of Islamic Law*, http://www.sunniforum.com/forum/showthread.php?6176-Maqasid-al-Shariah-The-Objectives-of-Islamic-Law(accessed: 25th August, 2014). It is a matter of fact that financing activities play a vita role in the increase of food production for society as a whole, and hence, having the character of social welfare. In addition, the goal of social welfare is achieved by the financial institutions through supporting farmers financially.

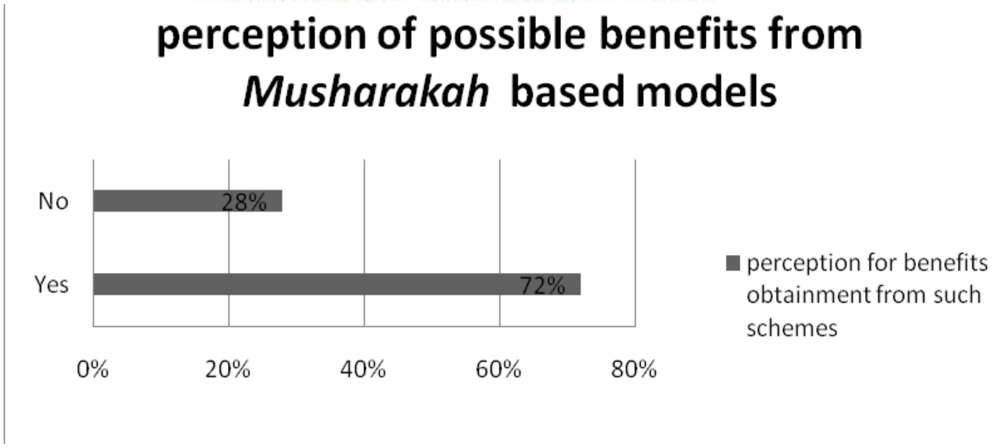


Figure 23: Perception of possible benefits from *Mushārakah* based models

The graphical presentation indicates that 72% of the farmers have positive perception regarding the role of *Mushārakah* (particularly the Diminishing *Mushārakah*) in the development of agricultural sector.

5.3.3 *Murābahah* Based Model and Financing Agriculture

5.3.3.1 Theoretical Background of *Murābahah*

As mentioned in the earlier discussion that *Sharī'ah* strictly forbids Muslim to secure loans on interest basis from any formal or informal institutions. Therefore, Muslim farmers in order to fulfill their agricultural requirements, both for crop and non-crop sectors have to resort to some other sources of financing recognized by Islamic commercial law in general, and by the Islamic financial system in particular. Among these sources *Murābahah* (cost plus profit based sale) is the most important and suitable financing that can be applied to the agricultural sector both for crop and non-crop activities. Before the practical application of this peculiar mode of Islamic finance for financing agriculture, it is appropriate to discuss its theoretical background both in classical and contemporary Muslim jurists' work.

A comprehensive work has been put in by the classical jurists on the concept of *Murābahah* like Imām al-Shawkānī[522], Imām al-Kāsānī[523], Ibn Qudāmah al- Maqdisī[524], Abū al-

---

[522]Shawkānī, *Nayl al-Awtār*.

Walid Muhammad ibn Ahmad ibn Rushd[525], Imam Muhammad ibn Ahmad ibn Abi Sahal al-Sarkhasī[526], and Ibn ʿĀbidīn[527]. Among these jurists, the work of Imām Muhammad ibn Ahmad ibn Abī Sahal al-Sarkhasī is remarkable in nature. In addition to the description of benefits for the society in a general way, they also discuss all rules and regulations of the concept in a very comprehensive manner. However, their discussions do not include the role of *Murābahah* in the agriculture sector. This may be owing to fact that majority of these jurists belonged to non-agriculture environments, unlike that of Pakistan. Some of the contemporary scholars also discussed the same transaction with a special reference to the modern Islamic banking and finance. These scholars include Muhammad Taqi Usmani,[528] Wahbā-al-Zuhaylī,[529] Shahid Hussain Sidique, [530] Mahmoud A. Gulaid,[531] Yūsuf Al Qardāwi (a renowned contemporary Muslim jurist)[532],[533] Abu Umar Faruq,[534] Muhammad Tahir Mansoori[535] etc. However, their discussion is very general in nature and does not include *Murābahah's* application as a mode for financing agriculture.

---

[523] Kāsānī, *Bādā'i'al-Sanā'i'.*

[524] Ibn Qudāmah al-Maqdisī, *Al-Kafī.*

[525] Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid.*

[526] Sarakhsī, *Al-Mabsūt*.

[527] Ibn ʿĀbidīn, Radd al-Muhtār.

[528] Muhammad Taqi Usmani, An Introduction to Islamic Finance.

[529] Wahbah-al-Zuhaylī, *Al-Fiqh-al-islāmī –Wa-Adilatuhū*.

[530] See for exam his work… Shahid Hasan Siddiqui, *Accounting Article Instruments of Islamic Banking in Operation*, Published on 4/21/2008,http://www.accountancy.com.pk/articles. (accessed July 25,2009)

[531] See for example his work …Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, Islamic Research and Training Institute Islamic Development Bank Jeddah, Saudi Arabia.

[532] Yūsuf Al Qardāwi is a prominent Muslim scholar belongs to Egypt. He was borne in September 9, 1926. He has written so many books on different subjects of Sharīʿahand his great efforts make him famous in the Muslim world. His work, unlike other contemporary scholars, related to the new issues faced by the Muslim world .His great work " *Al-Halāl Wal-Harām Fil-Islām'* can be cited as an example in this connection. He has also a lot of work on Islamic commercial law and has issued many Fatawas for the modern Islamic banking and finance. He has received many international awards for his unmatchable contribution to the development of both Islamic jurisprudence and Islamic Law.

[533] Yūsuf Al Qardāwi, *Bayʽ al-Murābaha lil-Aamir bi-Shirā Kamā Tujrīhi al-Masrif –al- Islamiyya:Dirssa fi Daw al-Nus*ūs *wa-al-*Qawāid *al-Shar'iyyah*. (Cario:Martabat Wahba, 1987).

[534] Abu Umar Faruq Ahmad, *Theory and Practice of Modern Islamic Finance: The Case Analysis from Australia* (United States, Florida,Brown Walker Press Boca Raton, 2010), p.200.

[535] Muhammad Tahir Mansoori ,*Use of Hiyal in Islamic Finance*, journal of Islamic Business and Management, Riphah International University Islamabad Pakistan, Issue No.1,November 1st 2011 ,vol.1.

"*Murābahah*" is a term of Islamic jurisprudence which literally means "profit". This literal meaning shows that it is a sale involving the original price along with additional profit.[536] In view Imām Al-Qurtabī "It is that kind of contract in which the seller describes price of the commodity to the buyer with conditional profit".[537] A well renowned Hanafī Jurist Imām Sarakhsī defines *Murābahah* in similar words, adding that it was a trust contract.[538] Imām Kāsānī, another great jurist of the same school views it as "the sale of a commodity at its original price along with additional known profit".[539] The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)[540] defines it as "The selling of a commodity as per the purchasing price with a defined and agreed profit mark-up.[541] While summarizing these definitions, this typical kind of sale can be defined as "a special kind of sale in which the seller expressly tells the purchaser how much cost he has incurred over the commodity and how much profit he is going to charge in addition to the cost". It is pertinent to mention if the seller does not disclose the cost incurred, it will not be *Murābahah* but another form of sale i.e. Musawamah [542] or Wadih'ah. [543]

---

[536] Marghinānī , *Al Hidāyah Sharh Bidāyat ul Mubtadī*,vol.5.p.152.

[537] Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, vol.2, p.375.

[538] Sarakhsī, *Al-Mabsūt* vol.5, p.77.

[539] Kāsānī, *Bādā'i'al-Sanā'i',* Kitāb al Baoy', vol.5, p.326.

[540] The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shari'a standards for Islamic financial institutions and the industry. Professional qualification programs (notably CIPA, the Shari'a Adviser and Auditor "CSAA", and the corporate compliance program) are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures. This institution was established in accordance with the Agreement of Association which was signed by Islamic financial institutions on 1 Safar, 1410H corresponding to 26 February, 1990 in Algiers. Then, it was registered on 11 Ramadan 1411 corresponding to 27 March, 1991 in the State of Bahrain. http://www.aaoifi.com (accessed Deceber 25, 2011)

[541] *Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)*, English Version, 2010, Sharī'ah Standard No.8, p.132.

[542] *Musāwamah* is a kind of sale in Islamic Commercial Law in which the seller is not in position to mention accurately the exact cost of the commodity or asset to the buyer .It is different from Murābaha in the sense that in the previous the seller is not obliged to mention the exact cost he incurred on the commodity, while in the latter he is obliged for mentioning the same. This type of commercial transaction is very useful for business activities as the parties agree on the price in the shape of bargaining before the contractual relation. Being a kind of sale, it has the same rules and regulations applicable to a regular sale.

[543] Marghinānī,vol.5.p.152.

Like other commercial transactions, Islamic commercial law also describes various rules and regulation for *Murābahah*. Being a special kind of sale, some of its rules are very much similar to that of normal sale transaction while others are merely related to it. However, for the purpose of brevity, all of these rules will be presented together.

Firstly, the seller must own the subject matter of sale or be an authorized agent of the owner.[544] Secondly, the sale must be instant and absolute in nature and therefore, any sale attributed to future date or conditioned to any future date is void.[545] Thirdly and more importantly, the price of sold commodity must be certain and predetermined at the time of contract. The main purpose behind this role is to avoid any future dispute.[546] Fourthly, the subject matter of sale must be legal from the perspective of *Sharī'ah*, and hence, sale of wine, pig, intoxicants, blood etc are not allowed.[547] Fifthly, the seller must be in possession to deliver the subject matter to the purchaser at the prescribed time mentioned in the contract.[548] Sixthly, the sold commodity must be certain in all aspects i.e. quality, quantity etc. The lack of such requirement renders the contact void.[549] The special rules prescribed by Islamic commercial law for a valid *Murābahah* includes the disclosure of original price at which the seller purchased the commodity. A transaction where the first price is unknown cannot be declared a legal *Murābahah* in view of Muslim jurists.[550] Moreover, the seller must inform the purchaser regarding the profit in addition to the original price. Furthermore, the exact cost incurred by the seller on the commodity must be known at the time of the contract. According to Muhammad Taqi Usmani Such cost includes freight, custom duty etc.[551] The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) also recognizes the inclusion of insurance cost under the same heading.[552]

---

[544] Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, vol.2, p.300;Kāsānī, *Bādā'i'al-Sanā'i'*,vol.5,p.2o.
[545]Wahbah-al-Zuhaylī, *Al-Fiqh-al-islāmī –Wa-Adilatuhū*, vol.5.p.3347.
[546]Ibid, vol.5 .p. 3353.
[547] Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, vol.2.221.
[548]Ibn Qudāmah al-Maqdisī, *Al-Kafī*, vol.2, p.11.
[549]Ibid, vol.2, p.12.

[550]Kāsānī, *Bādā'i'al-Sanā'i'*, vol.5, p.327.
[551] Muhammad Taqi Usmani, *Islam our Jadid Maeshat our Tijarat*, (Maktaba Marif-al-Quran, Karachi),p.164-147
[552]*Accounting and Auditing Organization for Islamic Financial Institutions*, English translation, p.119, Rule No.3/2/5.

5.3.3.2 *Murābahah* as a Financing Tool for Agriculture

Before presenting a viable model for financing agriculture on *Murābahah* basis, it is appropriate to set out the needs of farmers, particularly of those who are related to lower and middle class. The lower class farmers are generally in need of basic agricultural inputs e.g. seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers etc. In the researchers' point of view, this is an area of vital importance to the nation, which must be facilitated through agricultural finance. The logic is simple; superior quality inputs will give superior production both in terms of quality and quantity. During the study, a conclusion is drawn that most of the farmers, particularly in the rural area, buy seeds from the corresponding local market. Usually these seeds are of an inferior quality, and do not come with any guarantee provided from the local traders. In addition, this class of farmers is also in need of transport facility for various purposes. As for as the middle class of farmers are concerned, they have different agricultural needs than the previous class. For instance, they are in need of having agricultural machinery and equipment like threshers, power tillers, power & boom sprayers, ploughs, cultivators, riggers, drills, draggers, cotton pickers, saw machines for crate making, press machine for wheat straw and dry fodder, chisel ploughs, potato planter, sugar cane planter, rice trance planter, and self propelled reaper for harvesting wheat and rice crops.[553] Like the lower class farmers, such class of farmers is also in need of basic agricultural inputs like seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers etc.

The above mentioned requirements can be easily fulfilled by Islamic banks and other Islamic financial institutions through *Murābahah,* if the transaction is followed in its true spirit, rules and regulation prescribed for it in *Sharī'ah*. Therefore, the majority of farmers are supporting the same fact when they were asked whether they are willing to purchase agricultural machinery or purchase farm inputs (like seeds, fertilizers, pesticides, insecticides, herbicides, weedicides, manual sprays etc.) from a bank, if it can provide a commodity or farm inputs of good quality.(See figure No.25)

---

[553] *Guidelines on Islamic Agricultural Finane*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan,p.5.http://www.sbp.org.pk/guidelines/IslamicAgriculture/Guidelines-Islamic-Financing-Agriculture-01-09-2008.pdf(accessed December 27, 2011).

The agricultural requirements, both of lower and middle class farmers, mentioned in the previous paragraphs can be fulfilled through a very simple model where a farmer approaches the bank for the conclusion of commercial transaction. At the very first stage, the Islamic banks and other Islamic financial institutions go for the preparation of a feasibility report, owing to the fact that agriculture is always prone to natural risks drought, floods, hail, earthquakes, pests attack, mudslides and a multitude of other mishaps. Therefore, such institutions do not go for the investment of their liquidity without profound investigation of the application placed for the provision of financing facility. The farmer must sign an agreement with the financial institution, called Mastert *Murābahah* Facility Agreement (MMFA) or General Agreement (GA) or Mastert *Murābahah* Agreement (MMA).[554] The content of this agreement includes different details about the contract. These include the cost price of the agricultural commodity, profit, quality and quantity specification of the goods, the mode of payment, the nature of delivery, a promise from the bank that it will purchase the required commodity for the farmer and a promise from the farmer that after acquiring the asset he will purchase it from the bank etc. According to the majority of contemporary jurists, such a promise is binding in nature and, therefore, legal action can be taken against the farmer whenever he breaches his commercial promise.[555] The financial institution must purchase the agricultural commodity from the original seller by itself, however,

---

[554]Ejaz Ahmad Samdani, *Islamic Banking and Murābahah*,(Karach,Pakistan,Darul-Ishaat,First Edition ,2008), p.16.

[555]The tradition of the Holy Prophet (SAW) is clear about the non-binding nature of the Wa'ad (Promise) which states:"Malik related to me from Safwan ibn Sulaym that a man asked the Messenger of Allah (SAW) ,"Can I lie to my wife, Messenger of Allah?" The Messenger of Allah (SAW) said, "There is no good in lying." The man said, "Messenger of Allah! Shall I make her a promise and tell her?" The Messenger of Allah (SAW) ,said, "It will not be held against you"……… (Mālik ibn Anas ibn Malik ibn 'Āmr al-Asbahi (93-179 AH/711-795 AD), "*Muwtā*", vol.2, Hadith No. 1791, Dar al-turath al-Arabi, Egypt.). However, there are a number of Muslim jurists, especially Malikī who opine that promises are enforceable through the court of law especially when they are related to commercial transactions(Siti Salwani Razali, The Concept of *WA'AD* in Islamic Financial Contract ,http// www.kantakji.com/fiqh/Files/Finance/N418.pdf, (Accessed 20th April, 2012). Several verses of the Holy *Qur'ān* support their arguments For instance in the Holy *Qur'ān*Allah(SWT) states "And fulfill the commitment, for the commitment will be inquired into on the Day of Judgment" (Qurān, 17:24)and in another verse the same instructions are given "Fulfill the covenant of Allah when you have entered into it" (Qurān, 16:92.). The Hanafī Jurists have the opinion that promises cannot be enforced through the court, however, they accept the concept of a particular sale called "*Bay'-Bilwafā*". The view of the Malikī should be preferred as promises can be made enforceable as needed.(Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, *Mushārakah—A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Arab Law Quarterly, vol 28, issue 1, 2014,pp.: 1–39 (39).

this is the ideal situation and in case of dire need it can appoint the farmer as its agent.[556] For instance, as the Islamic banks and other Islamic financial institutions have no time to take such responsibilities themselves, they normally appoint an agent. Moreover, these institutions have no experience in dealing, identifying such assets or negotiating an efficient price and hence need an agency arrangement.[557] The contemporary jurists allow this mechanism with certain conditions. For example, it must pay the price of the commodity to the supplier directly and all title and shipping documents will be on its name. This arrangement will be mutually beneficial for both the Islamic bank and the farmer. The Islamic bank on this way will acquire the right commodity without its active participation, and hence would save time and cost. The farmer on the other hand will receive charges for his agency from Islamic bank, which will automatically reduce the price of the commodity for him. Moreover, he will acquire the commodity as per his/her own choice. However, majority of farmers denied this arrangement when asked about their willingness for the acceptance of customer agency (See figure No.26)

When the constructive possession of the agricultural commodity and its related risks and liabilities of the financial institution are confirmed, the same can be sold to the farmer on the conditions mentioned therein in *Murābahah* Facility Agreement (MMFA) or General Agreement. After the actual sale, the farmer can be asked to furnish security or guarantee as majority of the jurists have an opinion that the price becomes a debt on the buyer, and taking securities and guarantee for the protection of debt is permitted in Islamic commercial law.[558] Some of the scholars have the opinion that the Islamic bank can even ask for securities before the actual sale.[559] Such securities may be in the form of third party guarantee, a pledge of the

---

[556] "The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for it to carry out the purchase by authorizing an agent, other than the purchase order, to make the purchase, and the customer should not be appointed to act as an agent except in a situation of dire need. Furthermore the agent must not sell the item to himself; rather, the institution must first acquire the title of the item and then sell it to the agent"… *Accounting And Auditing Organization for Islamic financial institution (AAOIFI)*, 2010,English version, ,Sharī 'ah Standard No.8 R.3/1/3, p.117.

[557]Muhammad Tayyab Raza,*Murābahah Finance*, (Karachi, Pakisatn: Al-Huda IBE workshop at Avari Hotel). http:/. www.alhudacibe.com/(accessed June 16 ,2011).

[558]Sarakhsī, *Al-Mabsūt*,Kitāb-al-Sarf,vol.5, p.6.

[559]Ejaz Ahmad Samdani, *Islamic Banking and Murābaha*, p.73.

investment account of the farmer, or mortgage of his immovable property.[560] However, ground realities are against the provision of securities as majority of farmers belong to lower class and consequently are not in position to fulfill such requirements (See figure No.27).

Murābahah is a very useful transaction for all farmers. It is beneficial for the farmer in the sense that he acquires a commodity of good quality as compared to the quality of the same commodity that he can purchase from the local market. Similarly, if he buys the agricultural commodity from an Islamic bank then he has to pay the price in installments, but if he purchases the same from the local market, he has to pay the total price on the spot. This facility (payment in installments) is very much useful for lower class of farmers. The data collected on the same fact through focused group technique has proved the same fact (See figure No.28). In addition, by purchasing commodity from the Islamic bank, the farmer will receive two discounts i.e. discount received by the Islamic bank from the original supplier, and discount in the shape of subsidy given by the government on that commodity.

[560] *Accounting And Auditing Organization for Islamic Financial Institutions (AAOIFI)*, 2010, Sharī 'ah Standard No.8, English Version,Rule.5/2,p.121.

Murābahah Based Model

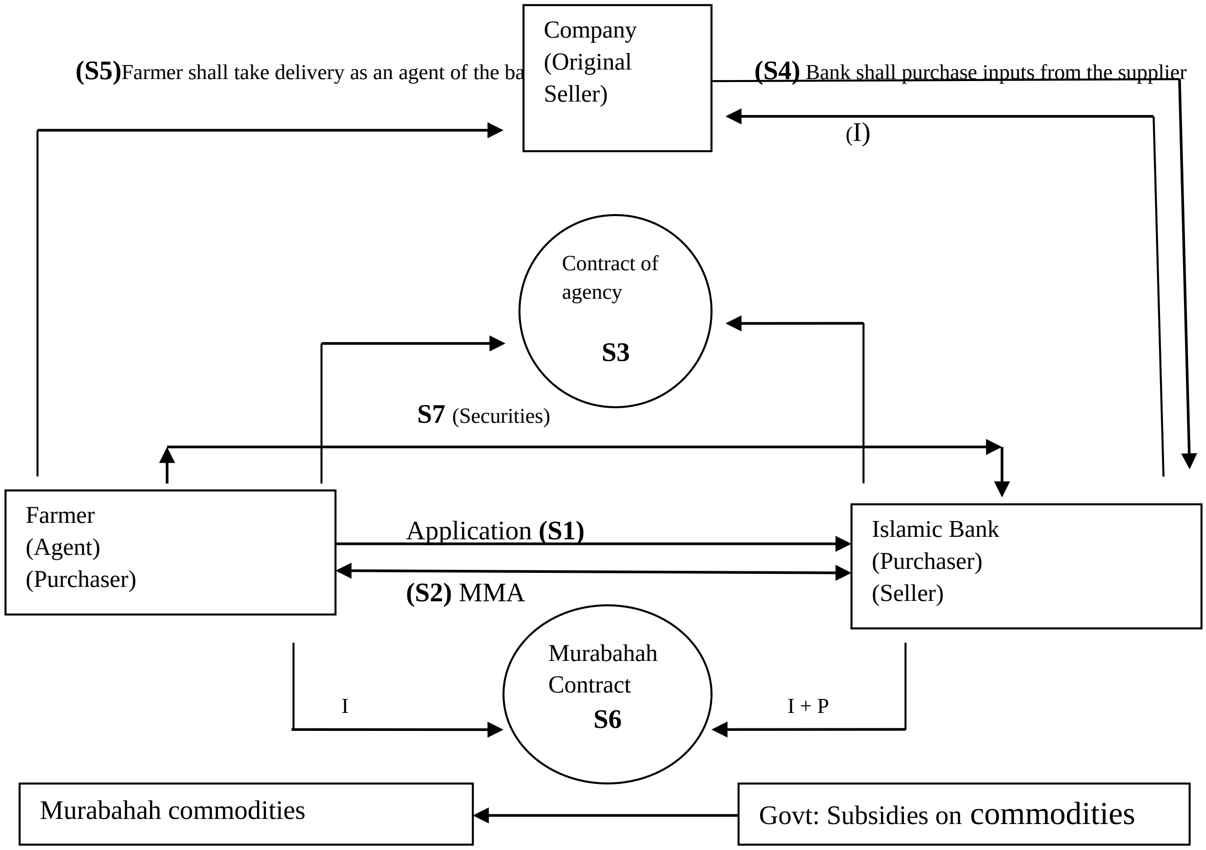


Figure 24*Murābahah* based Model

Murābahah is a very viable transaction that can be used successfully for the development of agricultural sector, particularly local farming in rural parts of the country. However, there are some issues in the existing structure of such transactions which must be considered before its application. Firstly, the bank must charge the minimum profit margin from the farmer. Arguably, by charging a reasonable profit from a farmer the banks can draw indirect benefits accruing in terms of future business possibilities. In addition, even the farmers are not ready to pay higher price to the bank for a commodity more than its price in the local market (See figure No.29).

After purchasing a commodity at a reasonable price, the poor farmer will continue his resort to the Islamic bank for other modes of Islamic financing. It is also possible that he will start depositing his savings with the same bank. If the institution intends to increase its business

in the agricultural sector, particularly in the rural area, then it must lower the profit percentage and keep itself focused on better future business prospects and possibilities. Secondly, the concept of *Hamish Jiddiyyaha* (earnest money)[561] and 'Arbuwn (advance payment)[562] should be eliminated as for as financing agriculture is concerned. In agricultural *Murābahah*, it does not seem suitable to take *'Arbūn* (advance payment) from a small farmer. It is advisable for the Islamic banks and other Islamic financial institutions to adjust the whole price of the commodity in installments rather than to take advance payment. However, being a permissible concept, 'Arbuwn' can be taken from the middle and upper class of farmers. As mentioned before, the purpose of agricultural finance is to cooperate and help the poor farmers by providing them the basic agricultural needs and requirements. Looking from that angle the application of *Hāmish Jiddiyyaha* does not appear logical. Even the farmers' community has rejected the concept of earnest money and is not ready to pay this amount (See figure No.30). It is the obligation of the Islamic financial institutions to help such farmers rather than to increase their burden.[563] However, one needs to find some alternatives for the Islamic financial system for safeguarding their interest, without which they would not be in a position to compete with the conventional banks. The basic principle of Islamic commercial law which states that "commercial promises are binding in nature", can serve this purpose.[564] Thirdly, the customer agency should be revised in financing agriculture and a very different approach should be made in this regard. For example, the Islamic banks and other Islamic financial institutions can appoint a farmer, other than the farmer who applies for *Murābahah*, to purchase the commodity. This farmer, based on his agricultural experience, will be able to identify the asset and negotiate an efficient price on

---

[561] *Hāmish Jiddiyyaha* is sum of money paid by the customer at the request of the institution, both as an indication of the financial capacity of the customer and to ensure the compensation of any damage to the institution arising from a breach of the customer of his binding promise.Having taken the *Hāmish Jiddiyyaha*, the institution need not to demand compensation for damage as this may be charged against *Hāmish Jiddiyyaha*.(AAOIFI,Standard No.8,Rule No 2/5/3,p.116).

[562] *'Arbūn*is called Down Payment. It is the amount paid by the customer to the institution as a part of the price. According to Accounting And Auditing Organization For Islamic Financial Institutions(AAOIFI) "It is permissible for the institution to take *'Arbūn*after concluding the *Murābahah* sale with the customer .This may not be done during the contractual stage at which the customer has given the promise to purchase .It is preferable that the institution return to the customer the amount that remains after deducting the actual damage incurred from the 'Arbuwn as a result of the breach ,namely the difference between the cost of the item to the institution and its selling price to a third party . (AAOIFI, Standard No.8,Rule No 2/5/6,p.117).

[563] Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transactions* , pp.101-102.

[564] See for details Mufti Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.120.

behalf of the Islamic bank. It can appoint such a person for a series of *Murābahah* transactions. The appointment of such farmer, other than the customer, is the ideal solution in the sense that the bank will not have to buy the commodity itself, and will also avoid customer's agency, which is not advisable from *Sharī'ah* perspective. The agency agreement between the farmer and the bank needs to be signed by both parties. The period for which such agency will be effective must be mentioned in the contract. This mandates the Islamic banks and other Islamic financial institutions to provide funds for the purchase of commodities required by the farmer.[565] He also has a duty to define a comprehensive list of assets and commodities that he, as an agent of the bank, may procure during the course of business from time to time. Fourthly, the minimum securities and guarantees should be demanded particularly from lower class of farmers as such farmers cannot afford the same and mostly avoid financing because of lack of appropriate securities. Fifthly, the existing procedure described by *Sharī'ah* Standards (AAOIFI) is very complex in nature and should be replaced with a simple procedure; understandable by illiterate farmers. Sixthly, the involvement of Islamic financial institutions in the business activity must be assured even if it is indirect. If all these suggestions are met, *Murābahah* based financing will be very helpful for the development of agricultural sector; both for crop and non-crop activities. The majority of farmers have the same opinion regarding this typical mode of Islamic finance (See figure No.31).

5.3.3.3 *Murābahah* Based Model on Trail

The above mentioned model is tested through focused group research in order to examine its viability, both for farmers and financial institutions. The following responses have been received from the respondents.

- Majority of farmers (70%) are willing to purchase agricultural machinery or purchase farm inputs (like seeds, fertilizers, pesticides, insecticides, herbicides, weedicides, manual sprays etc.) from a bank, if it can provide these (commodities or farm inputs) of good quality. The following graphical presentation is confirming the same.

[565]Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transactions*,p.98.

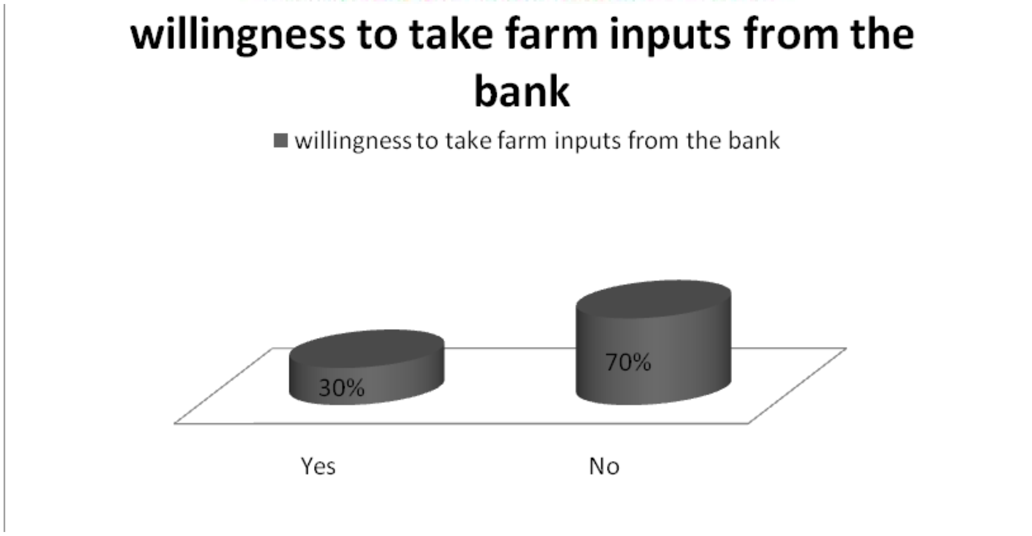


Figure 25: Willingness to take farm inputs from the bank

- Majority of farmers (respondents) do not accept the arrangement of customer agency and unwilling to become agent of the bank. The following graphical presentation has been drawn from response of the respondents.

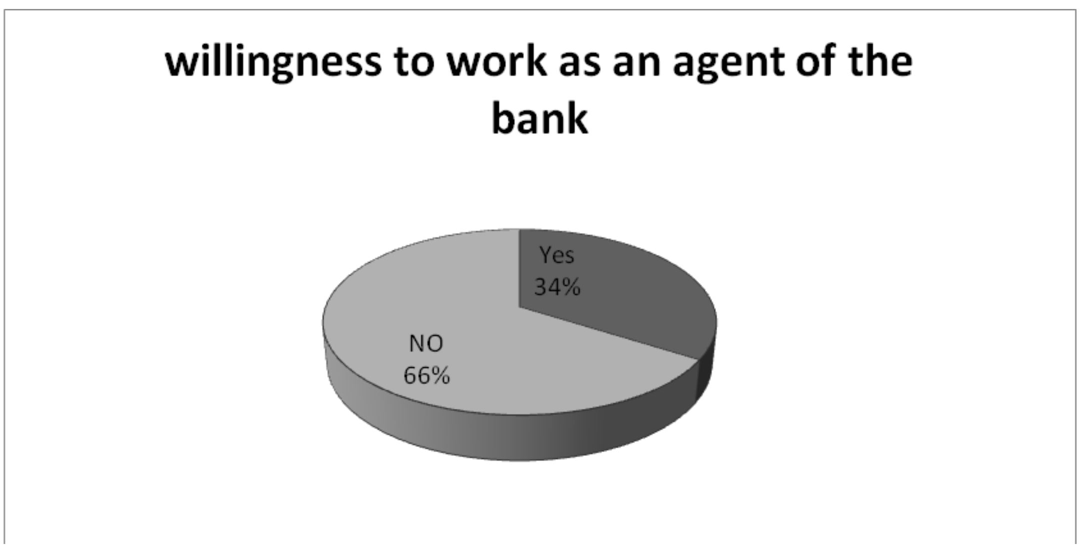


Figure 26: Willingness to work as an agent of the bank

It means that some alternate arrangements will be made for customer agency. The possible solution is that any other farmer, not the customer, of the same locality can be appointed by the bank as its agent (details are given in the discussion of *Mushārakah*).

- Ground realities are against the provision of securities (in case of *Murābahah*) as majority of farmers belong to lower class, and consequently, are not in position to provide securities and other forms of collaterals. The following graphical presentation can be cited as evidence, derived from the collected data.

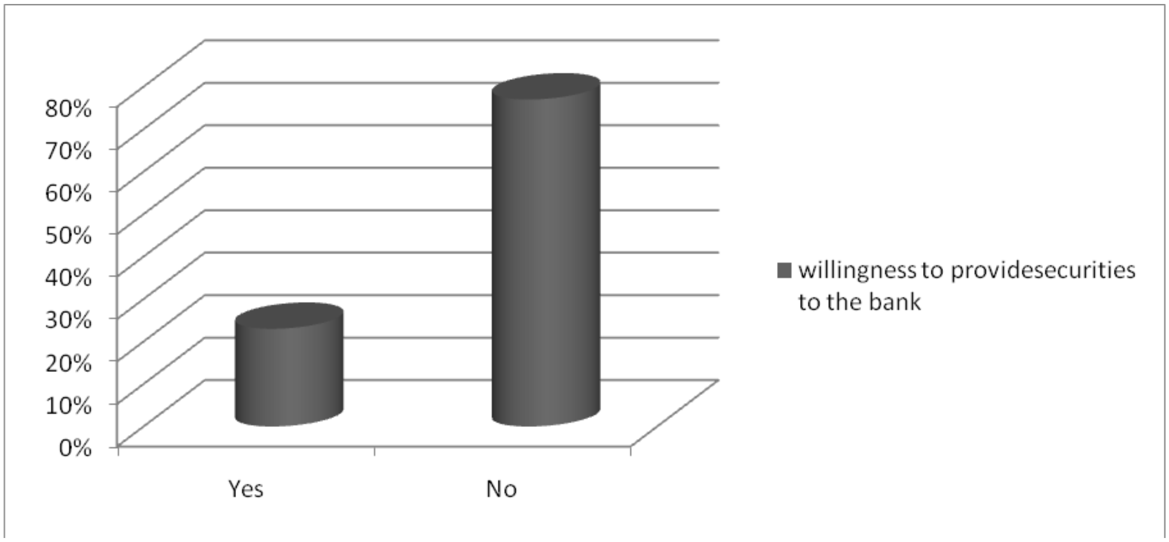


Figure 27: willingness to provide securities to the bank

Therefore, some other techniques should be followed by the financial institution for the protection of their liquidity. The best possible solution in this regard may be the provision of personal or group based securities.

- The facility of payment in installments is very much constructive for the lower class of farmers. Therefore, majority of farmers (respondents) accept to pay price of the *Murābahah* commodity in installments rather than to pay the same on immediate basis. The data collected on the same fact through focused group technique has proved the same fact.

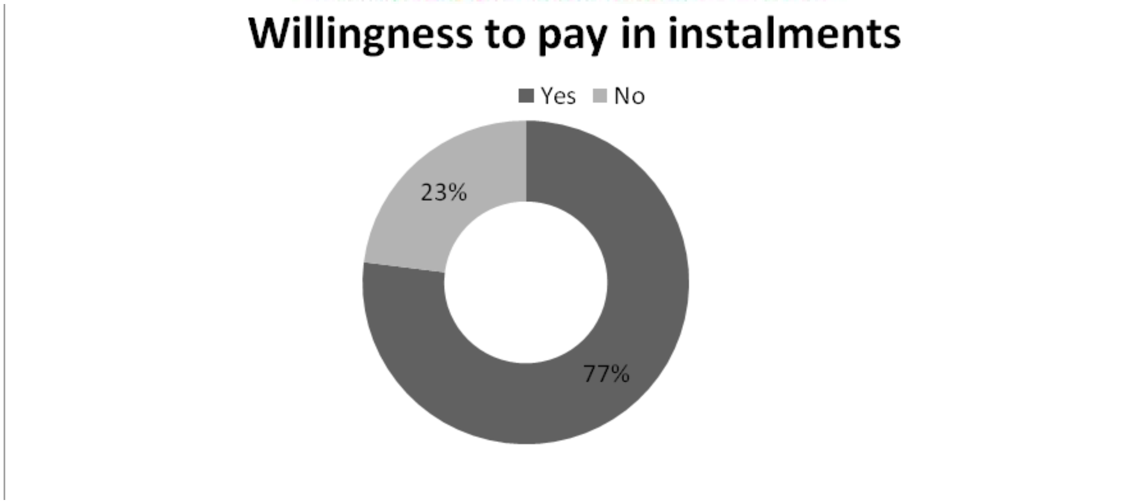


Figure 28: Willingness to pay in installments

- The farmers are not ready to pay higher price to the bank for a commodity more than its price in the local market. The following graphical presentation can be shown for their unwillingness on the same issue.

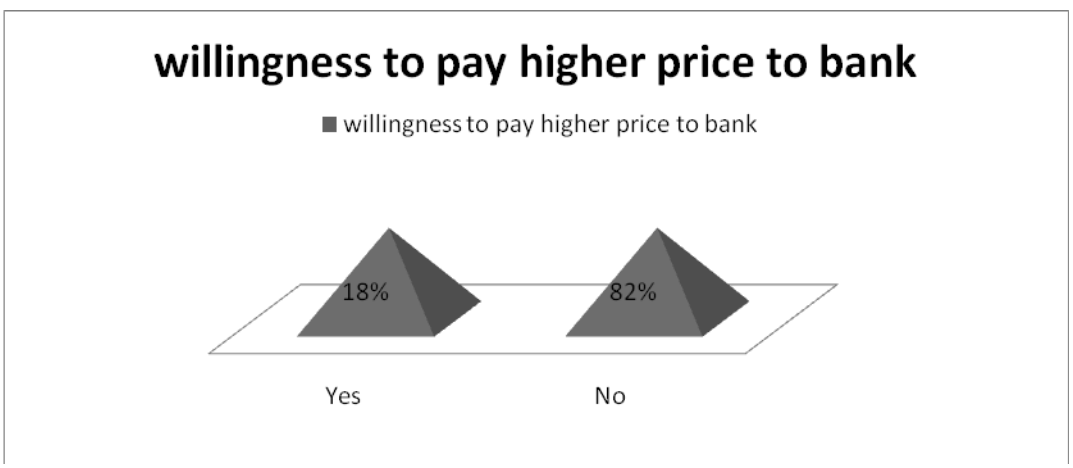


Figure 29: Willingness to pay higher price to the bank

It is, therefore, recommended that the Islamic banks and other Islamic financial institutions should take fewer profit margins from farmers as compared to ordinary customers. The government can also provide help through the provision of subsidies in this regard.

- Even the farmers' community has rejected the concept of earnest money and is not ready to pay this amount. The following graphical presentation may show their rebuff of the concept in the best possible manner.

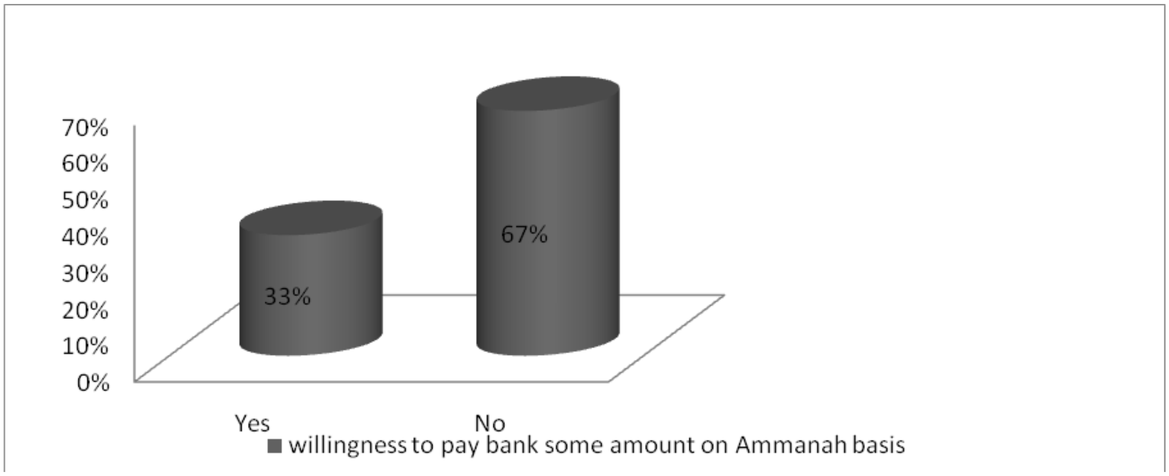


Figure 30: Willingness to pay bank some amount on *Amānah* basis

- If all these suggestions are met, *Murābahah* based financing will be very helpful for the development of agricultural sector; both for crop and non-crop activities. The majority of farmers (88%), from the groups, have the same opinion regarding this typical mode of Islamic finance. The following graphical presentation confirms the same fact.

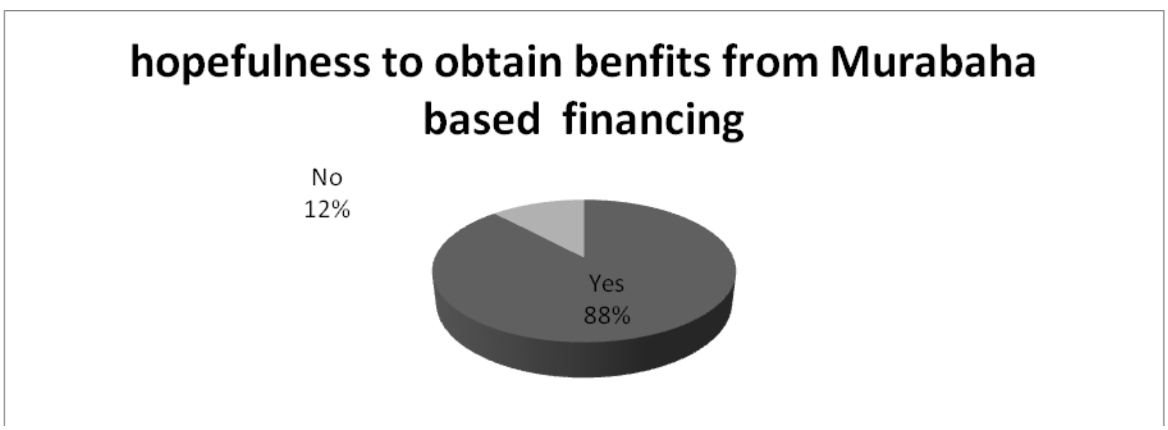


Figure 31: Hopefulness to obtain benefits from *Murābahah* based financing

5.3.4 *Salam* Based Model and Financing Agriculture

5.3.4.1 Theoretical Background of *Salam*

Muslim scholars, especially the classical jurists, have carried out comprehensive studies on commercial laws in light of the basic principles laid down by the Holy *Qur'ān* and *Sunnah* of the Holy Prophet (SAW), and compiled necessary details in their books. They duly classified the various commercial contracts and transactions into different categories; based on their objective and principal characteristics. They also applied *Ijtihād* on commercial transactions and outlined new statutes linking them to the specific needs of the time.[566] This demonstrates that Islam avoids putting firm rules over contracts and instead provides philosophic precepts that can be flexible and adaptable to changing times. Islam permits the law of exception where a commercial transaction, required by the community, becomes justifiable despite rejection by *Sharī'ah* such as *Bay'-al-Salam* (advance sale) and *Bay'-al-Istisnā' (*manufacturing sale). This type of transaction is justified on the grounds that it provides relief and facilitation to the masses. It is for this reason that some of these commercial transactions are justified on the basis of this exception even though they are in opposition to the basic principles and general rules provided by *Sharī'ah*. For instance, in Islamic commercial law sale of non-existing items is prohibited, and if this principle is followed strictly, many problems could be encountered delaying the smooth process of present day commercial activities. Therefore, *Salam* has been recognized by Islamic law through its famous doctrine known as *Maslaha* (Public Interest).

'Salam' is an *Arabic* word that means literally "to advance". This meaning has been incorporated in its technical meaning also. The Muslim jurists, both classical and contemporary, define this typical transaction of Islamic commercial law according to their own understanding of the concept. In the view of Kāsānî, a jurist of the Hanafī school of thought, "it is a sale in which the price is paid on immediate basis while delivery of the commodity is delayed."[567] According to Imām Shāwkanī "it is the sale of an ascertained property with a delayed delivery."[568] In the view of ibn Qudāma, a jurist of the Hanbalī School, "it is that kind of sale in which a present

---

[566] Muhammad Tahir Mansori, *Islamic Law of Contracts and Business Transactions*, p.x.

[567] Kāsānī, *Bādā'i'al-Sanā'i'*,vol.5, p.201.

[568], *Nayl al-Awtār*.Kitāb-al-Salam,vol.5, p.255.

commodity is sold for the deferred price related to the liability of the buyer.[569] Some of the contemporary scholars have defined *Salam* almost with the same approach as that of classical Muslim jurists. According to Wahbā-al-Zuhaylî, "it is the sale of an ascertained commodity with debt."[570]

Like other commercial transactions, *Sharī'ah* has provided legal justification for *Salam*. Some of the jurists resort for its validity to the verse of the Holy Qur'ān "O ye who believe when you contract a debt for a fixed term, record it in writing."[571] There are many traditions of the Holy Prophet (SAW) that help in determining rules and regulations, and that provide validation to this mode of Islamic finance. For example it is reported from ibn Abbas (RA) that the Holy Prophet (SAW) said "whoever wishes to enter into a contract of Salam, he must effect the *Salam* according to specified measure and the specified weight and the specified date of delivery".[572] There are other Hadith reported by Abdu Rehmn, Abû Saeed, ibnî Umar etc related to the concept of *Salam*.[573]

Islamic commercial law has described some rules and regulations for *Salam*, which must be followed in their true spirit otherwise the intended objectives of the transaction cannot be achieved. The most important among these rules is that the buyer must pay the price of the object in full to the seller in advance.[574] This rule should be strictly followed otherwise; the basic purpose of the transaction would be defeated.[575] Similarly, the *Salam* contract can be affected only on goods that can be weighed, measured and counted.[576] The basic purpose behind this role is the elimination of any future dispute regarding various specifications of the subject matter. Moreover, using debt owed to the purchaser by the seller as a price of the *Salam* commodity is

---

[569]Ibn Qudāmah al-Maqdisī, *Al-Kafī*, vol.2, p.108.
[570]Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol.5.p.3601.
[571]*Qur'ān*2:282.
[572]Shawkānī, *Nayl al-Awṭār*,Kitāb-al-Salam,vol.5, p.255.
[573]Ibid,vol.5,pp.255-256.
[574]Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol.5.p.3607.
[575]The wisdom behind the permissibility of *Salam* is to fulfil the instant needs of the buyer. If the payment is not made in advance, it defeats the purpose of the *Salam* transaction. Second, if the price is not paid in full then it will be the sale of debt for debt which is strictly prohibited by the Holy Prophet (SM)………………. Lutfullah Saqib, Kellie W. Roberts, Mueen Aizaz Zafar, Khurram Khan, *Salam -A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Journal of Hamdard Islamicus, issue No. 3 (July-Sep), 2014.
[576]Kāsānī, *Bādā'i'al-Sanā'i'*,vol.5, p.309.

prohibited. This prohibition is recognized because, first, it violates the principle that the price must be received by the seller in advance, and second, and more importantly, it is an exchange of debt for debt which is prohibited. According Muhammad Taqi Usmani *Salam* cannot be affected on a particular commodity, or on a product of a particular field or garden, as it is possible that the crop of that farm or the fruit and leaves of that specific tree could be destroyed before delivery.[577] Therefore, yield of a specific agricultural land cannot become the subject matter of a *Salam* transaction. According to Imām Sarakhsī and Imām Ibn ʻĀbidīn, jurists of the Hanafī school of thought, if it is a condition of the contract that the *Salam* commodity must be a product of a particular village or a particular field then such a contract will be considered invalid.[578] The Hanafî School of thought put a condition that *Salam* commodity must be in existence at the time of contract. However, by the word ‘existence’ such school means availability of the commodity in the local market from the inception of contract till the time of delivery.[579] The Muslim jurists also put a condition that the time of delivery must be determined and specified at the time of the contract. However, they have difference of opinion over the maximum time period.[580] In addition to the above rules, the Muslim jurists also allow the purchaser to demand any security from the seller in order to secure his debt. According to Imām Sarakhsī, a price becomes a debt which is related to the liability of a person.[581] Hence, if it is a debt, then the purchaser can take surety or pledge or both from the seller to ensure that the latter will supply the required commodity

---

[577]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.188.

[578]Sarakhsī, *Al-Mabsūt*, vol5; Ibn ʻĀbidīn, *Raddul al-Muhtār*, vol.4.p.131.

[579]Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, ʻAqd-ul-Salam, vol.5.p.3613.

[580]According to Hanafi and HanbaliSchool of thoughts, the time for delivery should be at least one month after the contract (Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol.5.p.3612.) and, if it is fixed before such a timeduration it will render the contract void. They support this view by saying that a *Salam* contract has been allowed for the needs of small farmers and traders and, therefore, enough opportunity should be given to them to acquire the commodity. They also argue that the price in a *Salam* transaction is generally less than the price at market. This concession may be justified when a reasonable time is given to the seller to deliver the commodity. Moreover, a period less than one month usually does not affect the price. According to the *Shafi'î* school of thought, the *Salam* contract can be immediate or delayed. According to Malikî school of thought the minimum time for the contract of *Salam* should not be less than fifteen days because the rate of markets may change beyond a fortnight.(Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, Kitāb-al-Salam,vol.2, p.357) The view of *Shafi'î* school of thought is more reasonable in nature as they give more importance to the consent of the contracting parties. The parties may agree on any time keeping in view of their corresponding interest. This view is more applicable in present day, and some of the jurists have also adopted this view considering its suitability for modern transactions. (Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.191).

[581]Sarakhsī, *Al-Mabsūt*, Kitāb-al-Sarf, vol.14, p.6.

according to the description mentioned in the contract. Being a typical kind of sale, the *Salam* transaction must have to follow all rules and regulations having indispensable nature for a valid sale. Therefore, the parties must have a legal capacity, free consent, the object and subject of the contract should be lawful, the price must be clear in all aspects, the seller must have ownership of the property or having the authority to sell it as an agent etc.

5.3.4.2 *Salam* as a Financing Tool for Agriculture

The *Salam* transaction is more useful than other modes of Islamic finance for financing agriculture. The reason for this usefulness is the very nature of the transaction that is originally structured and mechanized for financing agriculture. Majority of the respondents (farmers) have approved the usefulness of such transaction for the development of agriculture sector. (See figure No.40)**.** The historical background of this archetypal kind of Islamic commercial transaction, described by Muhammad Taqi Usmani, shows the same fact.

> Salam was allowed by the Holy Prophet (SAW) subject to certain conditions. The basic purpose of this sale was to meet the needs of the small farmers who needed money to grow their crops and to feed their family up to the time of harvest. After the prohibition of Ribā they could not take usurious loans. Therefore, it was allowed for them to sell the agricultural products in advance. Similarly, the traders of Arabia used to export goods to other places and to import some other goods to their homeland .They needed money to undertake this type of business. They could not borrow from the usurers after the prohibition of Ribā. It was; therefore, allowed for them that they sell the goods in advance .After receiving their cash price, they could easily undertake the aforesaid business.[582]

[582]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.186.

This illustrates how the contract of *Salam* existed and was employed by the people of Madina before the advent of the Holy Prophet (SAW), who later recommended the use of such a contract.[583]

The application of *Salam* to the agricultural sector is indispensable and inevitable. A survey conducted recently reveals that 64.5% of families belong to categories where one and two members are engaged fulltime in the agriculture industry. Farm income on an average represents 65%of total family income. Only 10.1% of families are fully dependent on agricultural income. The State Bank of Pakistan, reporting on rules of financing (2002) confirms that 70% of the agricultural credit requirements are met by informal credit providers who charge high interest rates. The survey shows that 46.5% of the total respondents return their loans after the sale of their crop while 45.5% return their loans whenever they receive money from other sources. About 61.5% of the farmers admit they face financial problems during the cultivation of their crops.[584]

Before presenting, a viable *Salam* based model for financing agriculture, it is appropriate to list those needs of farmers that can be met through such a transaction. These needs include the following.

1. Farmers, particularly those related to the lower class, are always in need of funds to purchase agricultural inputs like seeds, fertilizer and pesticides, etc. They also have a need of their own transport facility to bring their agricultural products to the local market so that the portion of their profits, normally used to pay others to transport their goods, may also accrue to them. These needs are usually required in local farming particularly that exists in rural part of the country which is a hub for majority of farmers.

---

[583]Lutfullah Saqib, Kellie W. Roberts, Mueen Aizaz Zafar, Khurram Khan,*Salam-A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Journal of Hamdard Islamicus, issue No. 3 (July-Sep), 2014.

[584]*Report on Rural Finance*,State Bank of Pakistan, 2002 http://www.sbp.org.pk/(accessed July 25, 2009).

2. Farmers are also in need of some capital for maintenance of their farm machinery and other agricultural implements. They have to pay labor charges, water charges, utility charges etc. [585]
3. The practical study of the agricultural sector reveals that farmers, especially those belonging to the poorer class, are facing many problems when trying to fulfill their agriculture needs.[586] One of the major hurdles faced by the farmer of rural areas relates to irrigating their crops, both for fruit and non-fruit crops.[587] If this problem is not solved properly then it may affect the agricultural production negatively in short term and may cause food shortage in future.
4. There are some problems faced by the farmers of local farming, particularly in rural parts of the country. For example, such farmers face problems at the time of selling their crops. They, of course, have no option but to sell their crops to the person with whom they have taken out the loan. In such a situation, the moneylenders commit exploitation by giving less price to the farmers for their agricultural products against the loan advanced. Similarly, due to the lack of proper transport facilities they are not in position to transport their crops to the nearest markets. Likewise, they also complain that they are unable to find customers who can give them ready cash, causing them to be without available funding for other requirements. In addition, improper auction tactics and dishonesty with weight assessment also create problems for these farmers. Finally, they complain that the buyers of their crops make their payments late; making it difficult for them to recover their profit once the crop is sold. The solution of all these problems is mandatory for the smooth development of agricultural sector.

All the above mentioned requirements can be fulfilled through the application of *Salam* transaction provided its application is made both in letter and spirit. For instance, the requirements mentioned above in category No.1, category No.2 and Category No.3 can be fulfilled through the provision of capital. In category No.1, the Islamic banks and other Islamic

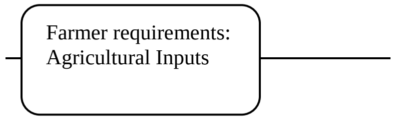
---

[585]*Guidelines on Islamic Agricultural Finance*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan.p.4.

[586]Lutfullah saqib,*Financing Agriculture Through Islamic Commercial Transactions*, p.124.
[587]Ibid,pp 124-125.

financial institutions may become a buyer of agricultural production by making an advance payment to the farmer.[588] However, unlike the moneylenders' exploitation, it is advised that the financial institutions should pay the maximum price for the commodity and should not cut down the price to a very low level in order to maximize their profit. This should be done for a national cause, owing to the fact of Corporate Social Responsibility (CSR) of the financial institutions towards the state and society at large. The requirement which is mentioned in category No.2 can also be fulfilled through the same way. Here the capital provided by the institutions against the *Salam* commodity can be used by the farmers for the maintenance and even hiring of heavy agricultural machinery. The following model may illustrate all details in the best possible manner.

***Salam* Model No: 1**



[588]*Guidelines on Islamic Agricultural Finance*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.4.

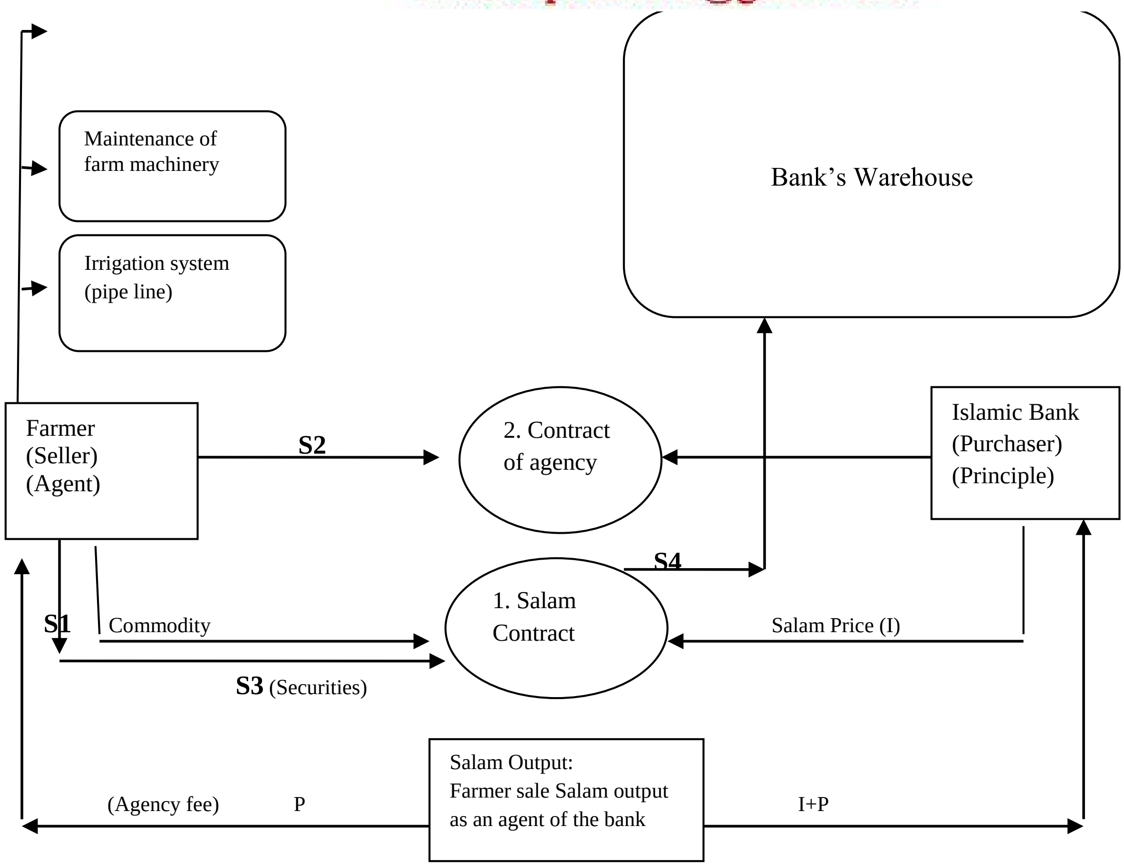


Figure 32: *Salam* model No 1

The problem of improper irrigation mentioned in category No.3 is very serious in nature, and, therefore, much attention will be given to its solution. Some of the researchers have comprehensively discussed the same problem in their work in detail. In their view although the weather tends to be rainy in this area, it cannot fulfill their needs, as the wastage of water is very high in Pakistan. The archaic method of flood irrigation wastes 50 to 60% of water used.[589] This technique leaves these poor farmers in extreme need of some alternative irrigation arrangements. A *Salam* contract can facilitate a solution to this common challenge. Farmers can use the funding they have received from the Islamic banks for the construction of water tanks, water pumps, tube wells, pipelines, and water channels. Pakistan's agriculture depends heavily on the gigantic

[589]Mohsin Ali,*Agriculture Problems in Pakistan And Their Solutions*,March 1, 2010, http://www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed July 13, 2012).

network of the canal-system.[590] Some reports mention that nearly 85% of Pakistan's cropped area is irrigated by these canals.[591]

> Since these are running expenses and IBI may not be able to finance these directly, therefore, one of the possible modes is Salam. Under this mode, IBI buys the output to be deliverable in future against the full spot payment of the price which may be utilized by the farmer to meet his financing needs.[592]

The hilly areas in the North of Pakistan pose a similar problem. For farmers in this area, the source for irrigation can neither be the river nor sea. Instead, cold springs are available in excess in these areas. However, to make these springs useful for irrigation a proper system of channels and canals must be put in place to provide a regular supply of water.[593] In the absence of this facility, the production levels in these hilly areas will continue to remain low. The Islamic banks and financial institutions can play a meaningful role by entering into *Salam* contracts with the small farmers of these areas to relieve them of this recurrent concern.

The problems which are mentioned in category No.4 can also be solved through *Salam* based arrangements. The *Salam* transaction between the Islamic banks and farmers may solve all these problems. For instance, entering into such a contract, the poor farmers can rid themselves of most of the aforementioned problems. For example, they will eliminate the problem of transport, will receive the price of their crops in cash, will receive their money in time, will not be deceived at auction or in weight, will not be required to follow the tedious procedure for loans, and will receive money in the beginning of a season in time to fulfill other agricultural

---

590 M. Sharif Zia,TariqMahmood, Mirza B. Baigand M. Aslam, *Land and Environmental Degradation and Itsamelioration for Sustainable Agriculture In Pakistan*, Quarterly Science Vision vol.9, no.1-2 (Jul - Dec, 2003) & 3-4 (Jan - Jun, 2004),p.1

591 *Pakistan's Food and Agriculture Systems*, Nathan Associates Inc. for review by the United States Agency for International Development,2009, p.5.

592 *Guidelines on Islamic Agricultural Finance*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.4.

593 Lutfullah Saqib, Kellie W. Roberts, Mueen Aizaz Zafar, Khurram Khan,*Salam -A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Journal of Hamdard Islamicus, issue No. 3 (July-Sep), 2014.

needs. Thus, the Islamic banks and other financial institutions can render great services for the farmers in order to overcome the many hindrances they face in the agriculture industry and, in the process, enable them to achieve their production targets. Because of the viability of the *Salam* transaction for the development of the agricultural sector, the majority of farmers agree to sell their future agricultural products to Islamic banks and other Islamic financial institutions for a price made on the spot. (See figure No.34)

There is a specific procedure described by Islamic commercial law for the contract of *Salam* which must be ensured at the time of its application for financing agriculture. Having originated as facilitation for farmers, the contract of *Salam* and its procedure is very suitable as far as the agricultural sector is concerned. The Islamic bank can draw a general framework or master agreement with the farmer. According to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) such a contract will be considered a memorandum of understanding where all details regarding the contract of *Salam* will be mentioned; including intention of the bank to buy and the intention of the seller to sell the *Salam* commodity, quantity, quality, and other necessary specification of goods, the time of delivery, the manner of delivery, the price, the manner for its determination, and the time for payment, etc.[594] However, there is no need of a master agreement (like the one which is concluded in *Murābahah*) and the parties must have to enter the contract directly. Being a typical kind of sale, the *Salam* commodity becomes the liability of the seller (farmer) and therefore, the Islamic bank can ask for securities to protect his debt (commodity in this case).[595] Such securities may be in the form of a third party guarantee, a pledge of the investment account of the farmer, or mortgage of his immovable property.[596] However, such securities should be avoided as far as financing agriculture is concerned. The reason is that a considerable number of farmers hold the land units of less than 12.5 acres, which is barely enough for providing subsistence standards of living. How it would

---

[594] *Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010*, Bahrain, English Version, Salam and Parallel Salam,Shari'a Standard No.10, Rule.2/1/1,p.163.

[595] Sarakhsī, *Al-Mabsūt*, Kitāb al Sarf, vol.14, p.6.

[596] *Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2010*, Sharī 'ah Standard No.8, English Version,Rule.5/2,p.121.

be possible for them to provide appropriate securities required by Islamic banks and other Islamic financial institutions. The following table can describe the whole situation.

Table. No. Land units held by farmers

Categories of Farmers	No. of Farms		Farm Area	
	Million	Percent	Total (million acre)	Percent
Marginal farms up to 5 acre	2.41	58.64	5.31	28.92
Small farms (5 – 12.5 acre)	1.70	41.36	13.05	71.08
Total small farms	4.11	100.00	18.36	100.00

Source: Agriculture census organization, 1990

Table 12: Land units held by farmers

The majority of farmers are also against the provision of securities required by the Islamic banks and other Islamic financial institutions (See figure No.35).

It is not necessary that the capital of *Salam* must be in the form of cash and it is quite possible that it may be in the form of fungible goods such as wheat and other grains, or in the form of general usufructs (i.e., living in a house) of a particular asset. In referencing this aspect of the contract, Wahba-al- al-Zuhaylî notes that the specifics of the price must be determined at the time of contract (i.e. weighable, measurable, or countable etc.).[597] However, when the capital of *Salam* is in the form of fungible goods such as wheat, rice, dates, etc, the parties must be careful not to fall in *Ribā* as mentioned in the *Hadith* of Obada ibni Samit.[598] This approach is quite helpful for local farmers as they receive good quality seeds as compared to that available in the local market. However, it is also a matter of fact that such kind of arrangements would bring many technical problems not only from *Sharī'ah*'s perspective but also from strategic and operational management of Islamic banks and other Islamic financial institutions. Therefore, in the agriculture sector, particularly in local farming, the capital of *Salam* to be given to the farmer must be in the form of cash. This method is preferred, firstly, because a farmer is usually not only in need of seed but also in need of cash to care for the family until the next harvest.

---

[597] Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*,vol.5, p.3605.
[598]Shawkānī, *Nayl al-Awtār,*Kitāb-al-Būyū', vol.5, p.217.

Receiving cash allows the farmer to use the funds as needed, which is the basic philosophy behind the contract of *Salam*. Secondly, if the capital of *Salam* is in the form of cash, it will protect both parties from falling prey to *Ribā* as mentioned earlier. Majority of farmers like to receive the capital of *Salam* in the form of cash. (See figure No.36)

As stated earlier that the basic purpose of *Salam* transaction is to help poor farmers financially at the time of intense need. Based on this fact, the Islamic bank must pay the price of the *Salam* commodity at spot.[599] However, the bank may delay the payment of price for two or three days because the institution is not a real person but a juristic personality and must follow specific procedures unlike an individual. In addition, much like a real person, the bank does not have money in its pocket to readily pay on the spot. Furthermore, for the approval of liquidity there is always proper documentation and specific procedure in financial institutions which cannot be fulfilled on an immediate basis. This view is supported by Imām Malik and according to him the seller may give a concession of two or three days to the buyer, but this concession should not form part of the agreement.[600] It must be kept in mind that such a delay should not exceed more than three days in any case. However, the financial institutions are advised to bring some changes in their procedures and conclude the contract and its implementation in a very short span of time.

Farmers tend to belong to the poor class of society and, hence, it is possible that a farmer may have taken a loan from the Islamic bank. In such a situation the latter cannot use such debt as a price of the *Salam* commodity because it will lead to the violation of three basic principles of Islamic commercial law. First, it will cause a violation because the price of a *Salam* commodity must be received by the seller in advance as stated by the majority of the jurists,[601] and second, and more important, it implies exchanging debt for debt which is strictly prohibited by *Sharī'ah*[602]and, last, paying the *Salam* commodity by debt may lead to the exploitation of the farmer and will be counterproductive to helping finance the farmer's production.

---

[599]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.187.

[600] Ibn Rushd, *Bidāyat al-Mujtahid wa Nihāyat al-Muqtasid*, Kitāb-al-Salam,vol.2, p.355; Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.187.

[601] For a detaied discussion Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*,vol.5, p.3611

[602] Sarakhsī, *Al-Mabsūt*, vol.14, p.6.

It is not permissible for the Islamic banks and other financial institution to stipulate in the contract with the farmer that the commodity should be from the farmer's land, farm, or garden because there is a possibility that crops of that garden could be destroyed before delivery. It is because of this reason that Imām Sarakhsī says that if it is conditioned in the contract that the *Salam* commodity must be a product of a particular village or a particular field then such a contract will be considered invalid.[603] The farmer can deliver the crops from personally owned land or from somewhere else but in either case it must satisfy and meet the specifications mentioned in the contract.[604] Empirical research shows that farmers are also in agreement with the same condition. (See figure No.38) If the farmer is unable to deliver the commodity, then certain situations may arise. Firstly, the farmer agrees with the Islamic bank to postpone the delivery until to the next crop. This option is not a reasonable one though as the bank loses out as a consequence of two issues. First, it will lose the opportunity to use the capital bound by the *Salam* contract and, second, it will have to wait for another period until the availability of the *Salam* commodity. Secondly, if the bank does not agree to the above option, then the farmer may return to the bank the price paid without any increase. This option, however, may be misused by the farmer. As discussed earlier, the price in *Salam* is less than the price paid in a cash sale. The farmer may sell the commodity somewhere else at a higher price, and may return the price paid to him by the Islamic bank with the pretence that he was unable to deliver the goods to the bank, for one or another reason. Thirdly, the contract of *Salam* can be cancelled by mutual agreement, and the Islamic bank will recover the paid capital. However, in this case too the Islamic banks and other Islamic financial institutions may suffer the loss.

It is also a matter of fact that Islamic bank may face problem while handling the commodity received from the farmer against the *Salam* price. The financial institutions are not familiar with dealing with commodities. In addition, it is against their business nature and handling commodities does not come in their comfort zone. But on the other hand, there must be a sort of feasible solution of the problem as it is indispensable for the Islamic financial institutions to go

[603]Ibid, vol.5, p.131.

[604]Lutfullah Saqib, Kellie W. Roberts, Mueen Aizaz Zafar, Khurram Khan,*Salam -A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Journal of Hamdard Islamicus, issue no. 3 (July-Sep), 2014.

for financing agriculture. This issue can be resolved through customer agency where the financial institution may appoint the customer as its agent and the latter may sell the commodity on its behalf. The data collected from farmers through empirical research has proved that majority of farmers like this kind of arrangement. (See figure No.39)

Mufti Muhammad Taqi Usmani has recognized the same problem. In his view if the Islamic banks want to earn *Halāl* profit they must deal in commodities because no profit is allowed in *Sharīʻah* on an advancing loan alone. It is, therefore, essential for these institutions to establish a special cell for dealing in commodities. Such a cell will sell the commodities received by the Islamic banks from the farmers in the local market.[605] He has brought the concept of parallel *Salam*[606] where the Islamic bank can sell the *Salam* commodity through another independent and separate contract to another customer. As the period of a *Salam* contract in the second transaction is shorter than the first one, therefore, the price in this second contract is higher than the price in the first *Salam* and this difference of price between the two transactions is a profit earned by the bank. In this way the bank will retrieve its money immediately which had originally been paid in the first contract. The Accounting and Auditing Organization for Islamic Financial institutions is of the same view,

> The obligations and rights under the first contract should not be linked with the obligation and rights of the second contract. Therefore, if one party breaches his obligation under the first *salam* contract, the other party has no right to relate this, damage or loss to the other party with whom he concluded a parallel Salam, consequently, he has no right on the basis of his loss or damage under the first Salam contract to terminate the second salam contract or to delay its performing.[607]

---

[605]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.193.

[606]The *Sharīʻah* supervisory board of Rajhi banking and investment corporation issued a Fatwa permitting the practice of parallel *Salam* on the condition that the execution of a second *Salam* should not be made dependent on the execution of the first one.(Al-Rajhi Banking and Investment Corporatoin, Collection of Sharī'ahFatawas, Resolution No.41. http://www.alrajhibank.com. (accessed August 25, 2012).

[607]*Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010*, Bahrain, English Version, Salam and Parallel Salam,Shari'a Standard No.10,Rule.6/3,p.167.

Parallel *Salam* Model No: 2

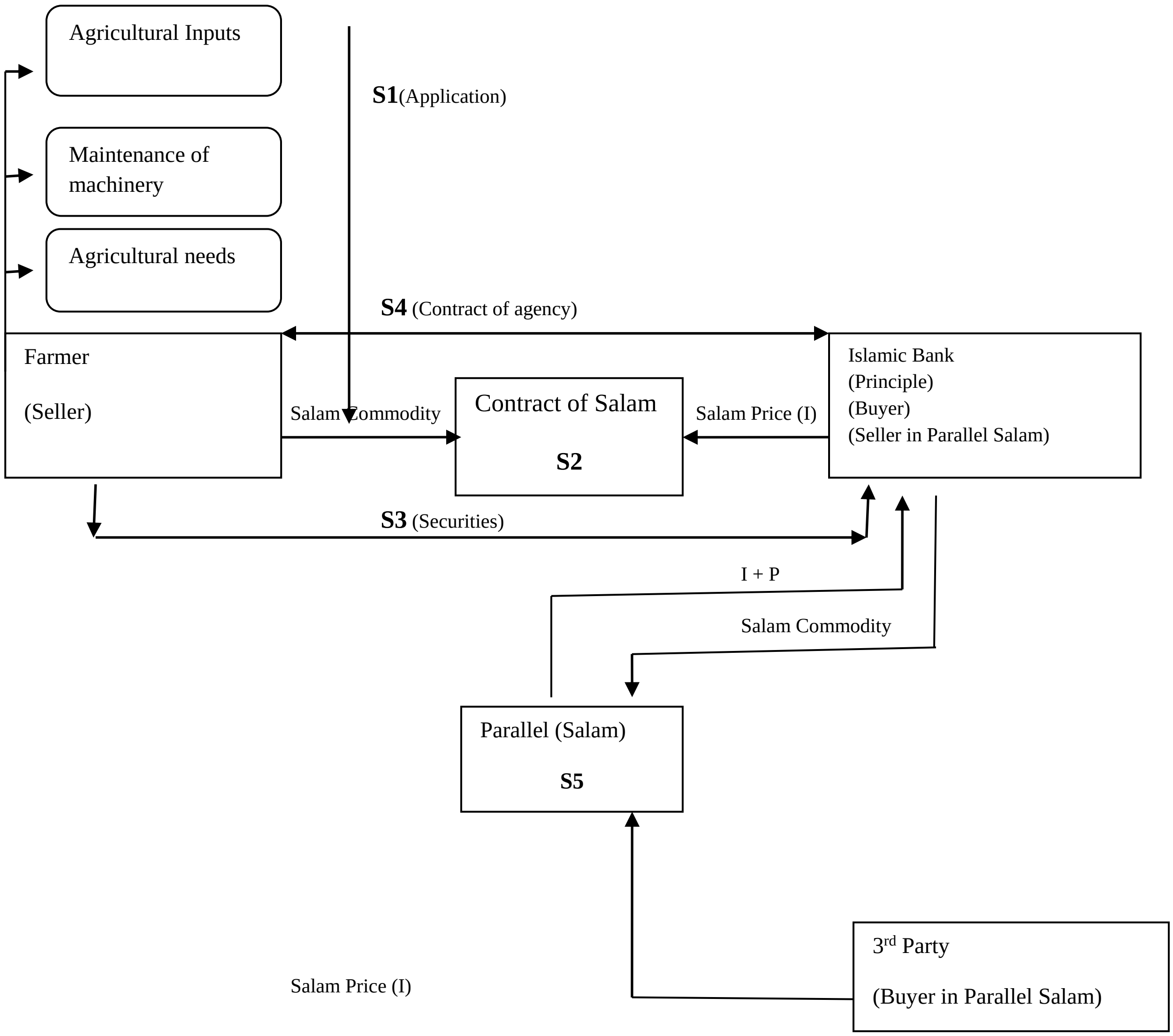


Figure 33: Parallel *Salam* model 2

If the parallel *Salam* is not feasible for one reason or another, then the Islamic banks can arrange another strategy. The bank must obtain a promise from the expected buyer. It is to be noted that such a promise will be unilateral and not bilateral as a bilateral promise leads to a

contract, and a contract on non-existing commodities is prohibited by *Sharī'ah*. Being merely a promise, and not the actual sale, the buyer will not have to pay the price in advance.[608] When the commodity is received from the farmer, the buyer will purchase the commodity from the bank at a higher price as compared to the price paid by the Islamic bank to the farmer. This difference between the two prices will result in a profit for the bank.[609] Sometime after the first contract, the Islamic bank enters into another contract with the same farmer to sell him the same goods at the same specific date but at a higher price. This, however, is not according to the basic principles of Islamic commercial law as it leads to a buy back transaction which is a way towards *Ribā* and is strictly prohibited by *Sharī'ah*.[610]

5.3.4.3 *Salam* Based Model on Trail (Survey)

The above mentioned model is tested through focused group approach in order to examine its viability, both for farmers and financial institutions. The following responses have been received from the respondents.

- Majority of farmers (87%), from the groups, are agree to sell their future agricultural products to Islamic banks and other Islamic financial institutions for a price made on the spot. The following graphical presentation may explain the situation in a best possible manner.

608Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.193.

609It is pertinent to mention that this idea has been described generally for Salam by Mulana Taqi Usmani, however it can be extended to the concept of Parallel Salam. See for further details Muhammad Taqi Usmani, *An Introduction to Islamic Finance*,p.193.

610 See for detailed discussion Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, pp.193-194.

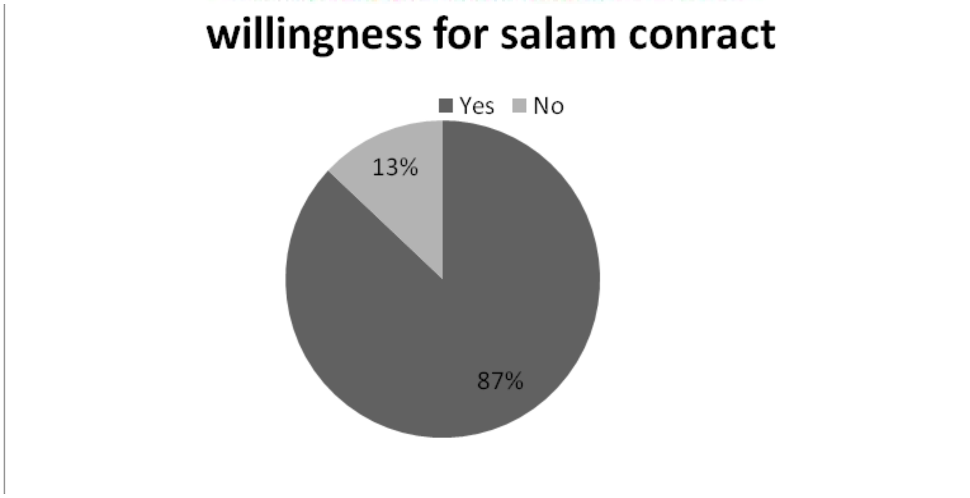


Figure 34: Willingness for *Salam* contract

- Majority of farmers (83%) are also against the provision of securities required by the Islamic banks and other Islamic financial institutions. The following graphical presentation clearly show their unwillingness

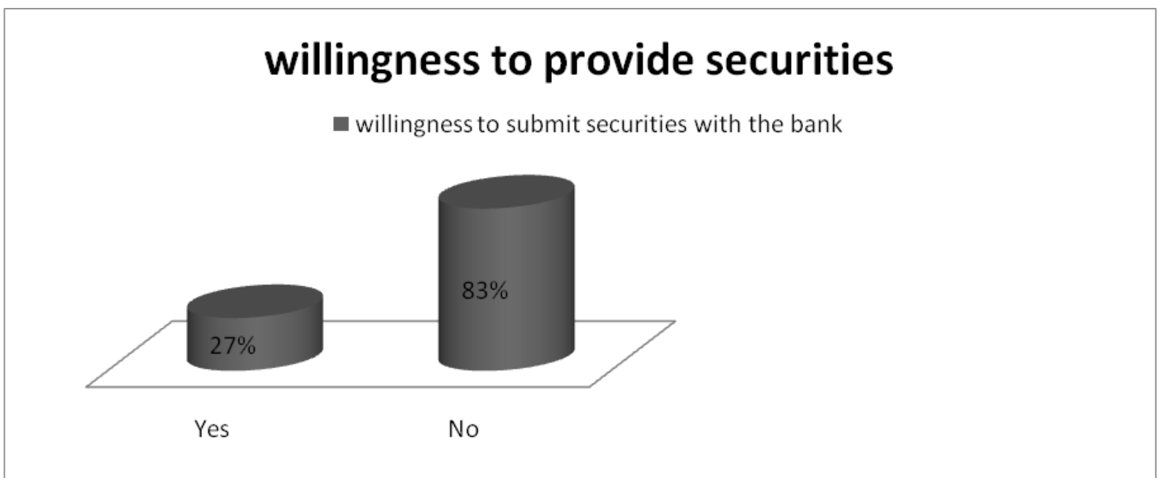


Figure 35: Willingness to provide securities

- Majority of farmer like to receive the capital of *Salam* in the form of money rather than inputs. The following graphical presentation confirms this fact.

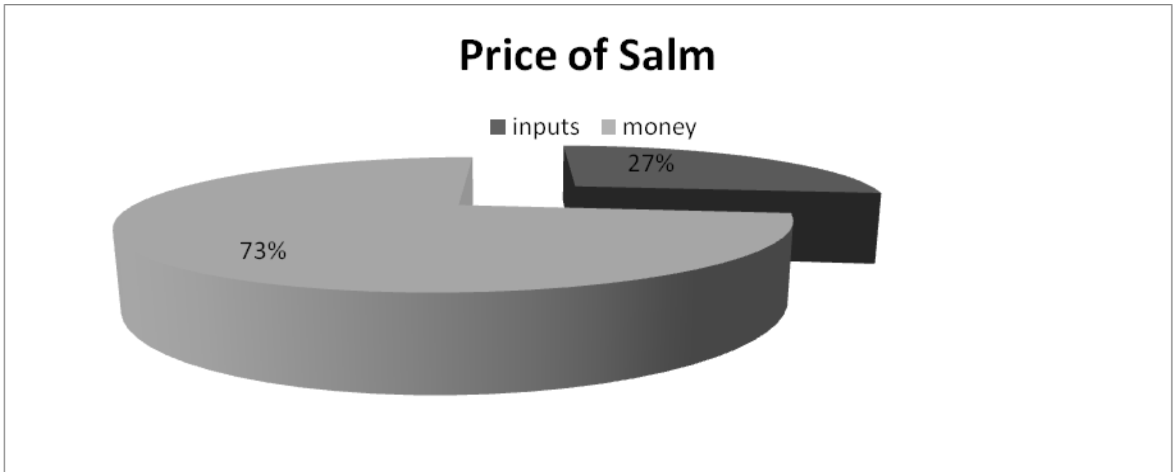


Figure 36: Price of *Salam* in the form of inputs or money

- A large number of farmers (42%) use the *Salam* price for non agricultural purposes like marriage, education, health etc. In order to confirm this fact the farmers were asked regarding the use of agricultural credit. Their response is designed in the following graphical presentation.

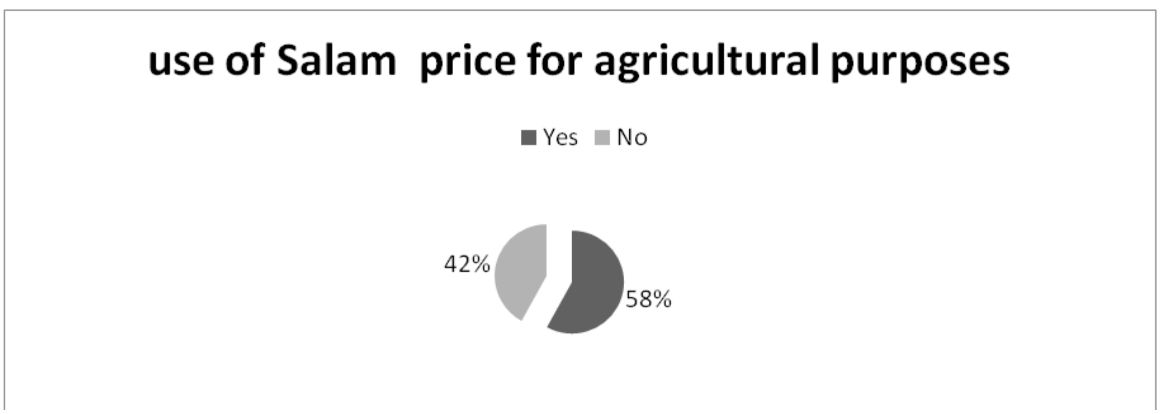


Figure 37: Use of *Salam* price

- Majority of farmers (90%), from the group, show their willingness to purchase the *Salam* commodity from the local market and deliver the same to the financial institution. The following graphical presentation has been designed from their response.



Figure 48: Willingness to arrange products in case of failure

- The data collected from farmers through empirical research has proved that majority of farmers (83%) are ready to become agent of the bank. The following graphical presentation may clearly picture the whole situation.

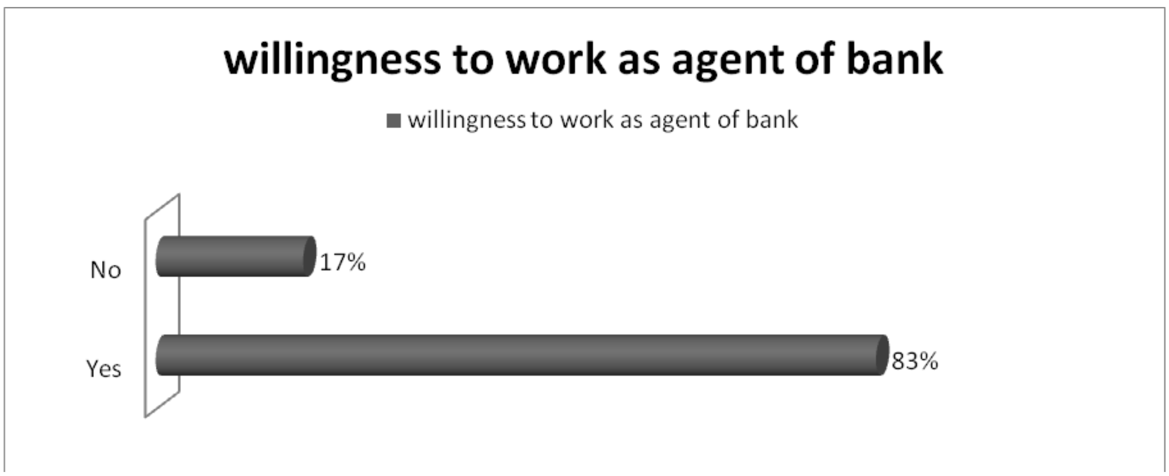


Figure 39: Willingness to work as agent of bank

- Majority of the respondents (farmers) have approved the usefulness of such transaction when they were questioned about the viability of this transaction for the development of their agricultural activities. The following graphical presentation is designed from their response.

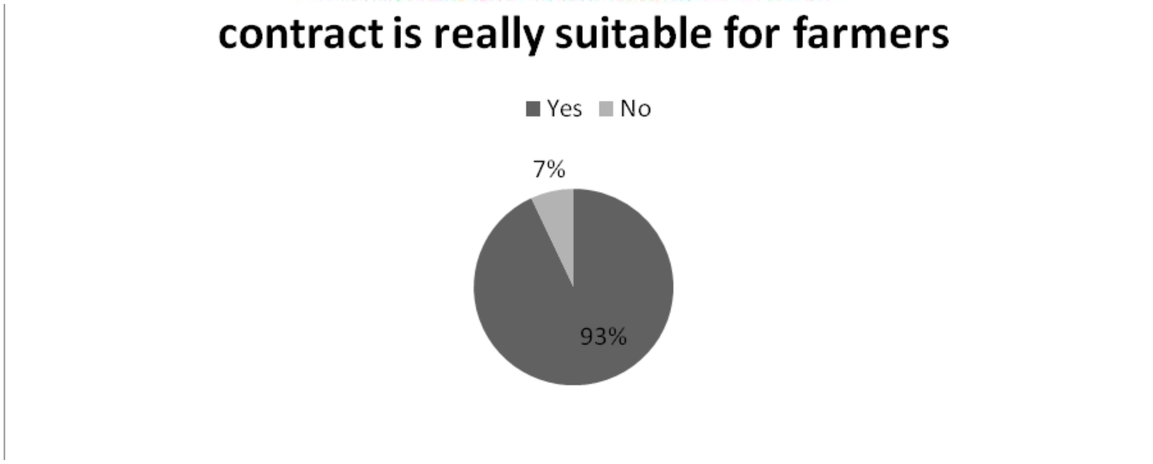


Figure 40: Contract is really suitable for farmers

5.3.5 *Istisnā‘* Based Model and Financing Agriculture

5.3.5.1 Theoretical Background of *Istisnā‘*

The concept of *Istisnā ‘*was first introduced by Islam. It is said that the Holy Prophet (SAW) once ordered for the manufacture of a ring of gold, and a barber to cut his hair.[611] The evidence shows that this kind of a transaction was not only permitted by the Holy Prophet (SAW), but was also practiced by him. It can be inferred from the above example that the contract concluded by the Holy Prophet (SAW) with the manufacturer or with the barber must have had certain rules and regulations i.e. nature of the commodity to be manufactured, price and its nature, payment and its different modes, time for the delivery, place of delivery etc. This would suggest that a whole description/fully fledged protocol was available regarding the contract of *Istisnā‘* at the very beginning of Islam. With the passage of time, the nature of the contract changed and turned from a simple to a more complicated one. Muslim jurists explained the concept further according to the various requirements of the time, keeping the basic principles in the contact. These jurists include Ābidīn, Kāsānī, Murginanī, Ibnī Qudāma, Ibni Rushd, Sarakhsī, Ibn Hazm, etc. [612] They devoted a separate chapter to the concept and discussed in detail its basic philosophies, rules, and regulations etc. However, their discussion of the

[611]Sarakhsī, *Al-Mabsūt*, vol5, p.139

[612] See for example work of Sarakhsī, *Al-Mabsūt*, vol5; Ibn ‘Ābidīn, *Raddul al-Muhtār*, vol.5; Kāsānī, *Bādā’i‘al-Sanā’i‘*,vol.5 etc

concept was a purely generic one and related to trade in general rather than specific sectors like agriculture. The reason may be that the environments in which they lived were not conducive for agriculture, and the people were in fact involved in local and international trade.

The contemporary Muslim jurists discussed the contract of *Istisnā‘* according to current requirements; however they relied entirely in their work on the rich literature available in the books of classical jurists with minute disparity in details. But it does not mean that they did not contribute to the literature of the concept. In the recent decades, with the emergence of Islamic banking and finance, they did a notable work on the concept and its application to different sectors of the society. These jurists include Muhammad Taqi Usmani,[613] Wahbā-al-Zuhaylî,[614] Muhammad Imran Ashraf Usmani,[615] Muhammad Anas Zarqa[616], Mirakhor, Muhammad Al-Bashir Muhammad Al-Amine,[617] Muhammad Faheem Khan,[618] Ahmed Moheddin Ahmad[619] etc. The contemporary scholars, related directly or indirectly to Islamic banking and finance, have not paid the required attention to the application of *Istisnā‘* to the agriculture sector. The reason behind it is that Islamic agriculture finance is completely a new area of investment for both Islamic banking and other Islamic financial institutions and therefore requires a lot of spade work to formalize the system. Certain scholars discuss the concept of *Istisnā‘* in their research work but not as a separate discussion, for example Muhammad A.Gulaid [620] Maulana Taqi

---

[613] See for example his work Muhammad Taqi Usmani, An Introduction to Islamic Finance,(Karachi :Maktaba Maariful *Qurān*, Edition August 2008) .
[614] See for example his work Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*.
[615] See for example his work Muhammad Imran Ashraf Usmani, *Meezan Bank's Guide to Islamic Banking,* (Karachi, Darul-Ishaat Urdu Bazar First Edition,2002).
[616] See for example his work Muhammad Anas Zarqa, *Istisna'Financing of Infrastructure Projects*, Islamic Economic Studies, vol. 4, no. 2, May 1997.
[617]See for example his work Muhammad Al-Bashir Muhammad Al-Amine,*Istisnā'and Its Application in Islamic Banking,* Arab Law Quarterly,vol. 16, no. 1, 2001 .
[618] See for example his work Muhammad Faheem Khan, *Islamic Future and Their Markets*, with special Reference to their Role in Developing Rural Financial Market, Islamic Development bank, Islamic Research and Training Institute, Paper no.32, p.41. http://www.irtipms.org/OpenSave.asp?pub=33.pdf(accessed July 14,2012)
[619] See for example his work ,*Sharī‘ah's opinion on Istisnā ' Contract and Salam*, Ahmed Moheddin Ahmad, Reviewed by Dr.Abdul Star Abu Ghddah, (Al-Barka Banking Group Department of Research and Development),p.12http://www.albaraka.com/media/pdf/Research-Studies/RSIS-200706201-EN.pdf(accessed Deceber 25, 2011).
[620]*Muhammad A.Gulaid, Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability,* ,p.50 http://farsi.ses.ac.ir/files/takmili/islamic_econ./capital_market/39.pdf (accessed May 16 ,2011)

Usmani ,Brian B. Kettell , Monzer Kahf and M. Fhim Khan, Ahmad Kaleem, Rana Abdul Wajid,[624] Magda Ismail Abdel Mohsin [625] Laurence M. Crane and David J. Leatham [626] ,Adam B. Elheraika[627] etc.

Some work has also been done on the application of *Istisnā‘* to the agriculture sector at the institutional level. In this connection, some Fatawa (verdicts) and guidelines are issued from different Fatawa and Islamic Financial Institutions. For instance, the State Bank of Pakistan issued a guideline on Islamic agricultural finance in which emphasis was given on the application of *Istisnā‘* to livestock, poultry farming, and fish farming etc. while local farming, the dominant requirement of the poor class, was completely ignored. Similarly, Bank Negara, the central Bank of Malaysia, also issued an academic document on *Istisnā‘*[628] but discusses the concept in general terms without any reference to agriculture finance. The State Bank of Pakistan issued a handbook on the application of Small and Medium Enterprises (SMEs) to agriculture sector.[629] However this document only traces the flow of the *Istisnā‘* transaction, its accounting

---

[621] Maulana Taqi Usmani, *Salam and Istisna*, An online publication by accountancy.com.pk, p.9.http://www.accountancy.com.pk/docs/islam_salam_istisna.pdf(accessed July 13,2012).

[622] See for example his work Brian B. Kettell, *Introduction to Islamic Banking and Finance*, John Wiley and Sons, 2011. http://books.google.com.pk/books?isbn=1119991277(accessed December 25, 2011).

[623]Monzer Kahf And M. Fhim Khan , *Short Term Financing of Commodity Production in Islamic Perspective*, Paper to be presented to the seventh annual meeting of the experts of Islamic banking, Kualalumpur, Spring 1992. http://monzer.kahf.com/papers/.../Financing_Commodit_Production.pdf(accessed Deceber 25, 2011).

[624]Ahmad Kaleem, Rana Abdul Wajid, (2009) "*Application of Islamic Banking Instrument (Bai Salam) for Agriculture Financing in Pakistan*", British Food Journal, vol. 111 Iss: 3, pp.275 – 292.

[625]Magda Ismail Abdel Mohsin, *The Practice of Islamic Banking System in Sudan*, Journal of Economic Cooperation 26, 4 (2005) 27-50 http://www.sesric.org/jecd/jecd_articles/ART05070102-2.pdf(accessed July 13,2012).

[626]Laurence M. Crane and David J. Leatham, *Profit and Loss Sharing in Agriculture: An Application of Islamic Banking*, Agribusiness, 1993, vol. 9, issue .4, pp. 403-412.

[627] Adam B. Elheraika, *On the Experience of Islamic Agricultural Finance in Sudan: Challenges and Sustainability*, Islamic Research and Training Institute Islamic Development Bank, Jeddah, 2003, 74 pages. Reviewed by: AHMED S. Bamakhramah Faculty of Economics and Administration Department of Economics King Abdulaziz University Jeddah, Saudi Arabiahttp://islamiccenter.kau.edu.sa/arabic/Magallah/Pdf/18_2/18-2-BaMakhramah_08.pdf (accessed July 13, 2012).See also his work Adam B. Elhiraika, 1996."*Risk-Sharing and the Supply of Agricultural Credit: a Case Study of Islamic Finance in Sudan*," Journal of Agricultural Economics, Wiley Blackwell, vol. 47(1-4), pages 390-402.http://ideas.repec.org/a/bla/jageco/v47y1996i1-4p390-402.html (accessed July 13, 2012).

[628] Bank Negara Malaysia, *Draft Sharī‘Ahparameter Reference 5: Istisnā‘ Contract*, http://www.bnm.gov.my/.../05.../06_concept_paper_shariah_para_ref_5_draft.pdf (accessed Deceber 25, 2011):

[629] State Bank of Pakistan, *Handbook on Islamic SME Financing* ,http://www.sbp.org.pk/(accessed Deceber 25, 2011).

treatment, and risk management issues etc. A Fatwa is also issued by Al-Baraka Banking Group on *Salam* and *Istisnā‘*.[630] This document discusses those commodities which can be manufactured through *Istisnā‘* transaction.

Istisnā‘ is an Arabic word originates from "*Sana*'" which means manufacturing, while regarding its technical meaning; the statements of *Fuqahā* vary considerably. Imām Kāsānî defines *Istisnā‘* as "a contract of something sold on guarantee in which the work is conditioned".[631] In the view of Ibn ‘Ābidīn, "It is a demand from a manufacturer to manufacture certain goods according to a given description".[632] Maulana Muhammad Taqi Usmani, a contemporary scholar, defines *Istisnā‘* as to order a manufacturer to manufacture a specific commodity for the purchaser.[633] Among these definitions the one which is given by Imām Ibn ‘Ābidīn, a well renowned and the latest Hanafî jurist, is more comprehensive because it tells about the basic principles envisaged by *Sharī‘ah* for the contract of *Istisnā‘*.

Like other commercial transactions, Islamic commercial law has described some rules and regulations for the contract of *Istisnā‘*. Being a typical kind of sale, some of its rules are similar to those of general sale while others are special in nature and solely approved by *Sharī‘ah* for it. In the coming lines only the special rules will be focused in details.

Firstly, in the contract of *Istisnā‘*, the manufacturer will make the required object from his own raw material owing to the fact that the subject matter of the contract is the object itself, and not the work done by the manufacturer.[634] This rule puts a demarcation line between the contracts of *Istisnā‘* and *Ijārah* (personal services) where the subject matter is the work which is to be done by the manufacturer. In this latter case the material is provided by the orderer. Imām Kāsāni in order to clarify the statement gives the example that if the orderer provided the blacksmith a piece of iron to make him a known vessel for an agreed fee, or provided a piece of

---

[630]*Sharī‘ah's Opinion on Istisnā ' Contract and Salam*, Ahmed Moheddin Ahmad, Reviewed by Dr.Abdul Star Abu Ghddah, (Al-Barka Banking Group Department of Research and Development),p.12http://www.albaraka.com/media/pdf/Research-Studies/RSIS-200706201-EN.pdf(accessed Deceber 25, 2011):

[631]Kāsānī*, Bādā'i'al-Sanā'i'*, vol.5, p.213.

[632]Ibn ‘Ābidīn, *Raddul al-Muhtār*, vol.4, p.221.

[633]Muhammad Taqi Usmani*, An Introduction to Islamic Finance*, p.195.

[634] Abdullah bin Mahmūd bin Muwdūd al Musilî Al Hanafî (Karachi,Qadimi Kutub Khana)Kitāb-al –Būyū',vol.2,p.46.

leather to a cobbler to make him a shoe for a known fee, then this is permissible but there is no choice (law of option) in it, and hence it is not *Istisnā ʼ* but hiring.[635] Secondly, *Istisnā‘* contract is not binding in nature before the work is started by the manufacturer, at which stage either party can revoke it.[636] This rule is based on the general principle of the contract of sale, according to which a party can revoke the contract before he leaves the place where it is concluded.[637] Similarly, when the manufacturer dies, automatically the contract of *Istisnā‘* comes to an end. This rule is applicable when the contract includes specific performance and the legal heirs of the deceased are unable to perform the contract. However in the absence of the condition of specific performance in the contract, they have to perform the contract. But it is pertinent to mention that the contract of *Istisnā‘* does not come to an end at the death of the customer, and his legal heirs have to accept the delivery of goods and make the payment. However in the researchers' viewpoint this rule should not be followed strictly and some flexibility needs to be shown according to the specific circumstances that may arise. Thirdly, *Istisnā‘* contract is very flexible regarding the aspect of payment. It is not necessary in this contract that the price is paid in advance, nor is it necessary that the price should be paid at the time of delivery.[638] Hence, the price may be totally or partially advanced or totally or partially deferred, or paid in installments, or any other way on which the parties agree. [639] Both the parties may fix the time of payment at the time of the contract. Fourthly, unlike as a rule of general sale, the time of delivery may not be fixed in an *Istisnā‘* contract, and, therefore, the commodity may be delivered at any time. The question arises whether the orderer has the right to reject it at that time. The jurists have different opinion in this regard. According to Imām Abu Hanifa, the purchaser (customer) has the right to reject the commodity after inspection if it is not according to the specifications laid down in the contract. He cites that since *Istisnā‘* is a sale; the law of option can be applied to it just like a normal sale transaction. However, according to Imām Abu Yousuf, if the commodity is

---

[635]Kāsānī*, Bādā'i'al-Sanā'i'*, vol.5, p.5.

[636]Kāsānī*, Bādā'i'al-Sanā'i'*, vol.5, p.4; Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.196

[637] Ibn Qudāmah al-Maqdisī, *Al-Kafī*, Kitāb-al-Būyū', vol.2, p.43

[638]*Istisnā ʼ* Contract in Islamic Fiqh, Publication Series of Tadamon Islamic Bank, (Shaban.1412, February.1992, Fatawa and Research Department), p.17.

[639] Muhammad Faheem Khan, Islamic *Future and Their Markets, with special Reference to their Role in Developing Rural Financial Market*, Paper no.32, p.41.

according to the specifications agreed upon by the contracting parties then the purchaser is bound to accept the commodity and has no other option.[640] Fifthly, for the validity of *Istisnā'* it is necessary that the subject matter is non-existent at the time of contract. The reason is that purpose of such contract is to manufacture something and an exception to this rule is strictly prohibited.[641] If the commodity is already in existence, and there is no need to manufacture it, then the justification for *Istisnā '*permissibility loses its ground. In the latter situation the contract of *Salam* is the most suitable. Sixthly, the *Istisnā'* is not binding in nature, and therefore, can be revoked by either party without the consent of the other before the manufacturer starts the work.[642] *Majallah-al-Ahkam-al-Adiliyyah*, however, does not accept the view point of Hanafi School of thought regarding the non-binding status of *Istisnā'*.[643] The approach of *Majallah* sounds more logical though because it is in the interest of both parties to a contract.

5.3.5.2 *Istisnā'* as a Financing Tool for Agriculture

Istisnā' arguably is the ideal mode of Islamic finance which is applicable, especially for non crop activities. Such mode of Islamic finance is not the most appropriate mode for crop activities since its contract is concluded only where there is a definite demand already established.[644] .Following this principle it can be said that such contract cannot be concluded for natural goods or commodities.[645] In other words it cannot be applied for financing fruit crops or for non-fruit crops activities.[646] The description shows that this transaction's role is more dominant in the non crop sector and hence can be used for the development of local farming; particularly in the rural areas of the country where 62 percent of the country's population resides, and is directly or

---

[640]Kāsānī, *Bādā'i'al-Sanā'i'*, vol.5, p.5.
[641]Shawkānī, *Nayl al-Awtār*, vol. 5, pp. 174-175.
[642]Kāsānī, *Bādā'i'al-Sanā'i'*, Kitab-al-Istisnā', vol.5, p.4; Muhammad Taqi Usmani, An Introduction to Islamic Finance, p.196.
[643]*Majallah al-Ahkām al-'Adaliyyah*,the civil code of the Ottoman Empire (Hanafi), section.392
[644] Muhammad Faheem Khan ,*Islamic Future and their Markets ,With Special Reference to their Role in Developing Rural Financial Market*, Islamic Development bank ,Islamic Research and Training Institute ,Paper No.32,p.41.
[645]Ibid, p.41.
[646]It means that such contract cannot be applied for financing wheat, paddy, sugarcane, cotton, potato, mustard, mung, tobacco, rapeseed, maize (Hybrid), Maize (local), Mash, canola, lentil, soybean, groundnuts, sunflower, pear, dates, loquat strawberry, plum, tea, apple, guava, papaya, pomegranates, almond, palm, coconut, olive oil, litchi, cherry, mango. zizi, apricot, melon, banana, water melon, peach, mush melon, citrus etc.

indirectly linked with agriculture for their livelihood.[647] These areas remain mostly ignored in terms of financing by the Islamic banks and other Islamic financial institution.

The above discussion does not mean that *Istisnā'*s application is limited only to non crop agricultural activities and it cannot be used for the solution of other agricultural problems faced by farmer. For example, one of the major problems faced by the farmers of rural areas is related to watering their crops, including both fruit and non-fruit crops.[648] Although Pakistan has rains in most places and has the monsoon season as well, but these rains alone cannot fulfill their needs owing to the very high water wastage in the country. The archaic method of flood irrigation wastes 50 to 60 percent of water.[649] Because of this reason, they need some alternative arrangements which can overcome their problems, and educate them on water savings at the same time. This can be possible by entering into *Istisnā'* based arrangements. They can ask the Islamic banks and other Islamic financial institutions to construct for them water tanks, water pumps, tube wells, pipelines, channelizing water from reservoirs (Pakistan's agriculture depends on the gigantic network of canal-system; [650] some of the reports describe that nearly 85 percent of Pakistan's cropped area is irrigated by canals[651]), creating small passages which can be used to water their fields crops etc. Majority of our farmers are facing severe irrigation problems to supply water to their land through pipes or channels. Most of them need tube wells to overcome this problem. Along with the tube well, farmers also need of a proper system of pipes and channels which can properly irrigate their crops. These problems have been rectified by majority of farmers when they were asked about the major irrigation problems. The following graphical presentation confirms the same.

---

[647] Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan Ministry of Finance, Chapt.2,p.13http://www.finance.gov.pk/(accessed July. 6, 2012).
[648] Ibid,pp 124-125.
[649]Mohsin Ali,*Agriculture Problems in Pakistan and their Solutions*,March 1st 2010, http://www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed July 13,2012).
[650] M. Sharif Zia, TariqMahmood, Mirza B. Baigand M. Aslam, *Land and Environmental Degradation and Its amelioration for Sustainable Agriculture in Pakistan*, Quarterly Science, Vision vol.9, no.1-2 (Jul - Dec, 2003) & 3-4 (Jan - Jun, 2004),p.1.
[651]*Pakistan's Food and Agriculture Systems*, Nathan Associates Inc. for review by the United States Agency for International Development,2009,p.5 http:// pdf.usaid.gov/pdf_docs/PNADO507.pdf (accessed July 13,2012).

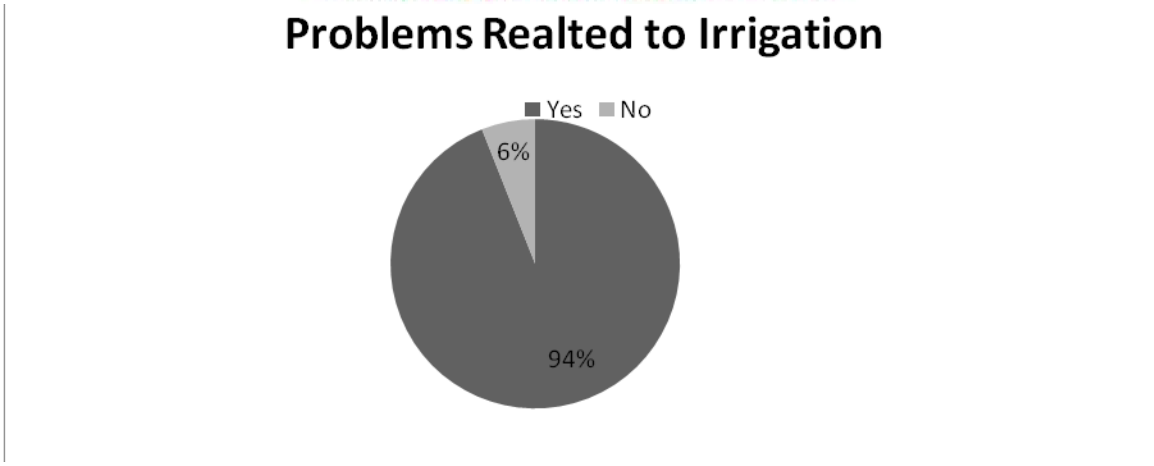


Figure 41: Problems related to irrigation

*Istisnā ’*contract can help facilitate this link between the farmer and Islamic bank or Islamic financial institution. Similarly, farmers living in hot and cold areas are generally in need of permanent sheds to protect themselves from sun, heat and cold. Study reveals that these sheds are very important for farmers who normally work from six to eight hours at a stretch in their field, both in summer and winter seasons, and need take rest and respite from weather. Moreover, most farmers' houses are remotely located from their fields making it difficult for them to move necessary equipment, back and forth, like rake, hoe, fork, shovel, spade, hand fork, trowel, wheel barrow, and watering can etc. These sheds come handy for storage purposes as well. Farmers also use these permanent sheds or rooms to keep their fruits or corps to protect them from the bad weather, increasing their shelf life.

In hilly areas the source for irrigation for farmers is not the river's water but the cold springs that are excessively available in those areas. For them it is necessary to have a proper system of channels and canals for the regular supply of water to their fields. In the absence of such facility, their production levels reduce manifold. The Islamic banks and other Islamic financial institutions can help out farmers of such areas through the conclusion of *Istisnā‘* contract with them.

Most farmers reside remotely from their fields, and some of them do not even have their own house but live on rent. In order to solve both these problems, the contact of *Istisnā‘*, in the view of researchers, is the best solution because according to a well established principle of Islamic commercial law, it is permissible to draw up an *Istisnā‘* contract for real estate

developments on designated land own by the final purchaser.[652] While applying this principle, along with the principle that the price of *Istisnā'* contract may be in the form of cash or tangible goods or the usufructs of an asset for a particular duration, a farmer can request the Islamic bank or financial institution to construct a house on the land owned by him. When the construction of the house is completed, the farmer will transfer its usufructs (residence) to the Islamic bank, as a price for *Istisnā'* contact. After this, the Islamic bank will lease the house to the farmer on rent for a particular period of time.

Istisnā' can be affectively used with the same potential for the development of livestock,[653] fish farming,[654] poultry farming,[655] and miscellaneous other areas of agriculture. This further

---

[652] *Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010*, Bahrain, English Version, Istisnā 'and Parallel Istisnā ',Shari'a Standard No.11,Rule.3/1/8,p.181. Mujeeb Baig, *Istisna as Mode of Financing*, http:// www.alhudacibe.com/...%20Istisna%20)/Istisna%20by%20Mujeeb%20Baig.ppt(accessed July 21, 2012).

[653] The government of Pakistan, since last two years worked for the development of this sector and achieved solid results and resultantly. It witnessed a marginally higher growth of 4.04 percent against the growth of 3.97 percent last year. (*Pakistan Economic Survey 2011-12*, Highlights p.1.http://www.finance.gov.pk/survey/chapter_12/highlights.pdf - Cached(accessed July 15,2012)The Islamic banks and other Islamic financial institutions can also help farmers in rearing their livestock through *Istisnā'*. They can conclude such contract for the installation of milk storage chilling tanks, refrigeration plants, milk carrying containers, refrigerated meat storages and refrigerated containers, distribution vehicles such as motorcycles, pickups, refrigerated vans, construction or procurement of permanent sheds, water tanks, water pumps, tube wells and generators, fencing and enclosures, establishment of slaughter houses (*Guidelines on Islamic Agricultural Finance*, Islamic Banking Departmen, State Bank of Pakistan, p.5) for cows, sheep, buffaloes, goats ,installation of tube wells, turbines, sprinkle or drip irrigation system, animal sheds, refrigerated storage, and fencing slaughter house water management etc(Muhammad Khaleequzzaman, *Islamic Modes for Agricultural Financing Products – Murabahah and Salam* , Al – Huda Training Programme,2008. http:// www.alhudacibe.com/.../...(accessed July 15,2012).

[654] Pakistan has total coastline of 1,120 km covering Mekran (Balochistan) as well as the coast of Karachi (Sindh) and a total fishing area of approximately 300,270 sq. Km. (Fishing Industry in Pakistan ,Overview, http:www.pakistanfishing.com/fishing-info/fishing-industry-in-pakistan.(accessed July 15,2012) Because of the viability of this sector, the government of Pakistan has taken some solid steps for its development in the last few years .Because of this reason fisheries sector witnessed a growth of 1.78 percent against the growth of 1.94 percent last year. (*Pakistan Economic Survey 2011-12*, Highlights p.1.http://www.finance.gov.pk/survey/chapter_12/highlights.pdf - Cached(accessed July 15,2012)*Istisnā'* can also be applied for the effective development of fish farming. This can be done by the construction of cold storage, chilling or freezing plants, fish storage centre, pickups, vehicles, life boats, and fish or shrimp hatcheries etc. (*Guidelines on Islamic Agricultural Finance*, Islamic Banking Department, State Bank of Pakistan, p.6.

[655] *Istisnā'* is also effective in its implementation to the poultry farming. It can be used for the construction of broiler, layer, breeder and hatchery farms, feed mills, control seeds, automatic drinkers, tube feeders, generators, ventilators, table or breeder eggs storage refrigeration plants, transport vans, eggs and poultry carrying vans, distribution vehicles such as motorcycles, pickups, deep freezers, slaughtering and de-feathering machines etc (*Guidelines on Islamic Agricultural Finance*, Islamic Banking Department, State Bank of Pakistan, p.5.

increases its importance, even for middle and upper class of farmers, as all these sectors require a great deal of investment in the beginning of the business. This mode of Islamic finance is therefore equally viable for all individuals. While this provides a source of livelihood for the poor farmers, it ensures a sound source of business for the middle and upper farming classes.

It is pertinent to mention that Islamic banks and other Islamic financial institutions are financial institutions by origin, and therefore, it is almost impossible for them to manufacture the required agricultural commodity (demanded by a farmer) by themselves. In order to cope with the situation, the Islamic bank may also conclude *Istisnā‘* contract with a manufacturer to manufacture a commodity of the same description mentioned in the previous *Istisnā‘* contact concluded with the farmer. It is, however, not necessary that the time of delivery and price in the second contract is the same as in the previous one; since that would inconvenience the bank. Once the commodity is manufactured, it will be delivered to the bank directly or to any other party on its behalf decided mutually in the contract.[656] This arrangement is typically known as parallel *Istisnā‘*.

[656] Ezzedine Mohd. Khoja ,*Instruments of Islamic Investments* , Dallah Al-Baraka Group Research & Development Department Instruments of Islamic Investment http:// www.iefpedia.com/english/wp.../Instruments-of-Islamic-Investments.pdf (accessed July 15,2012).

***Istisnā'* Based Model No. 1**

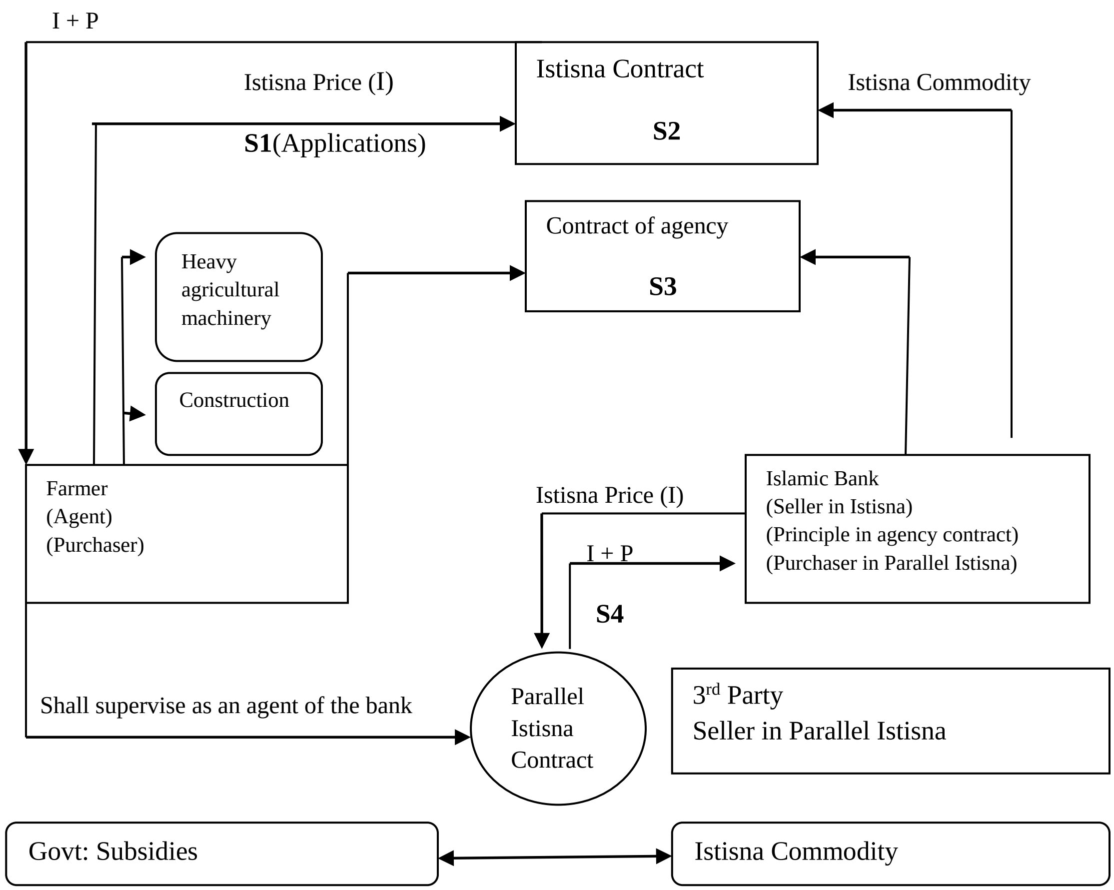


Figure 42: *Istisnāʻ* based model 1

However, in the view of some researchers this type of arrangement (parallel *Istisnāʻ*) is not beneficial particularly for lower class of farmers owing to many reasons. Firstly, the farmers have to give higher price for the commodity as there are two prices i.e. the price paid by the Islamic bank to the manufacturer and the price paid by the farmers to the Islamic bank, and the difference between these two prices is the benefit of the Islamic bank. Due to the inclusion of a separate contract, price of the commodity increases and because of this reason it is not wrong to say that parallel *Istisnāʻ* contract is not in the interest of poor farmers.[657] Secondly, the degree of risk for a farmer increases in the parallel *Istisnāʻ* contract as compared to direct *Istisnāʻ* contract.

---

[657]Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transaction*, p.127.

It is quite possible that the manufacturer or construction company may not manufacture the required commodity or the required building within the stipulated time period which is mentioned in the contract. Under such circumstances, the Islamic bank cannot buy the required commodity from the local market because usually the *Istisnāʻs* commodity is manufactured by order. These are not primary goods as mentioned earlier, but produced when there is a specific, already established demand.[658] In this case the farmer will face the consequences for the default of others (manufacturer) whereas the bank will recover its loss through penalty clause.[659] Thirdly, the contract of parallel *Istisnāʻ* brings complexity in the procedure which can create difficulty for an illiterate farmer (majority of farmers in Pakistan are illiterate and ignorant[660]). But it does not mean that its application should be entirely ruled out for the agricultural sector rather it should be limited only to those commodities which cannot be manufactured without a particular company. For example, if the farmer requests the Islamic bank to manufacture for him a tractor or motorcycle or pickup or refrigerated van, then in such a situation the bank has no alternative except to enter in the contract of parallel *Istisnāʻ* with the manufacturing company of such vehicles.[661] For the common construction requirements e.g. buildings, bridges, factories, tube wells, permanent sheds, water channels and pipelines, digging wells other then tube wells, fencing and enclosures, establishment of slaughter houses, water tanks, water pumps etc, it may be a situation for the Islamic banks or other financial institutions to have their own construction company and expert contractors to discharge the task.

There is a specific procedure mentioned in Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) for the contract of *Istisnāʻs*. According to this document, a farmer must give some specifications of the required commodity while entering into a formal contract with the Islamic bank. These specifications include type, kind, quality, and quantity etc.

---

[658] Muhammad Faheem Khan, Islamic *Future and Their Markets, with special Reference to their Role in Developing Rural Financial Market*, Paper no.32, p.41.

[659] Aniss Boumediene, *is Credit Risk Really Higher in Islamic Banks?*,The Journal of Credit Risk ,vol.7, no. 3, Fall 2011,p.103.

[660]Mohsin Ali,*Agriculture Problems in Pakistan and their Solutions*,March 1st 2010, http://www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed July 13,2012).

[661]Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transactions*, p.128.

In addition, the price of the commodity, date of delivery, place of delivery must be mentioned in the contract. The clearance of all these specifications is declared mandatory by Islamic commercial law in order to avoid any future dispute between the contracting parties. At the conclusion of this step, the Islamic bank will order the manufacture to manufacture the commodity which it has undertaken to manufacture in the first *Istisnā‘* contract. At this stage it is necessary that the specifications mentioned in the first contract are also stated verbatim in the second contract. When the required commodity is produced, then before delivery, the commodity will remain at the risk of the Islamic bank, but when the possession is transferred to the farmer, which may be actual or constructive, then risk will also be transferred to him. [662]It is clear that transferring of authority from the Islamic bank to the farmer to use the property, utilization, and consumption will be considered constructive possession. In addition, when the agricultural commodity, required by a farmer, is manufactured or constructed or produced, then there is no need for a farmer and Islamic bank to renew the offer and acceptance for the sale or purchase of the required commodity.[663] At this particular point the difference between *Istisnā‘* and *Murābahah* transaction arises. In the latter case the actual sale or purchase of the required agricultural commodity must take place. So, it is easier for an illiterate farmer to understand the procedure of *Istisnā‘* as compared to that of *Murābahah.* It is the duty of Islamic bank to deliver the commodity on the due date and not before that because according to Islamic commercial law, if the manufactured goods are delivered before due date, the farmer can refuse to accept the delivery which in this case may create problems for the Islamic bank. However, there has to be some logic for such refusal.[664]

As mentioned earlier that *Istisnā‘* is a kind of normal sale transaction with some peculiar characteristics. Like ordinary sale it is not necessary in this contract that the price must be paid in advance, nor is it necessary that the price should be paid at the time of delivery.[665] Hence, the price may be totally or partially advanced or totally or partially deferred, or paid in installments,

---

[662]*Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010*, Bahrain, English Version, Istisnā ’and Parallel Istisnā ’,Shari’a Standard No.11,Rule.6/4,p.185.

[663]Ibid, Rule.2/2/2, p.179.

[664]Ibid Rule.6/3,p.185.

[665]*Istisnā’ Contract in Islamic Fiqh*, Publication Series of Tadamon Islamic Bank, (Shaban.1412, February.1992, Fatawa and Research Department), p.17.

or any other way on which the parties agree.[666] However, majority of farmers opt to pay in installments owing to the fact of their meager economic conditions. The data received through empirical research shows the same fact. The following graphical presentation may describe the whole picture properly.

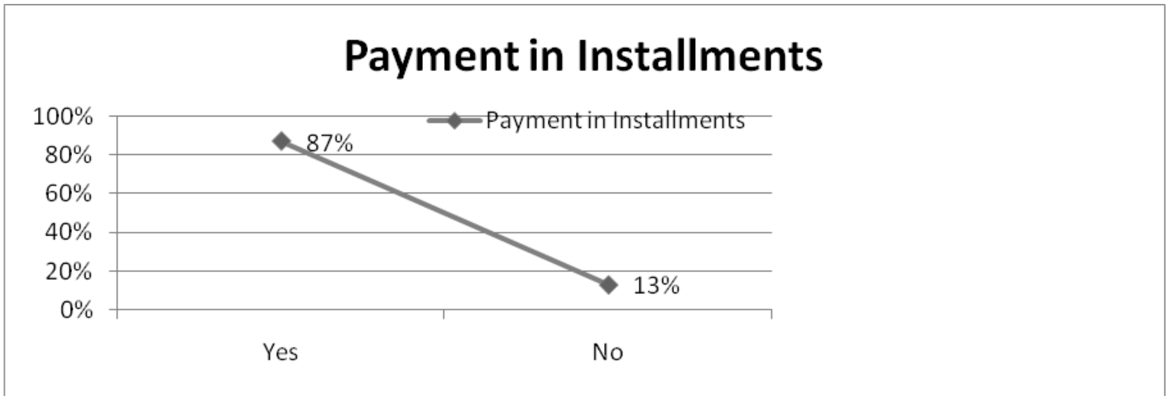


Figure 43: Payment in installments

The presentation clearly indicates that 87% of farmers, from the focused groups, like to pay in installments rather than on spot. This tendency (delayed payment) is very much beneficial for the financial institutions as in this case the charged price for commodity will be more than the one charged on spot. However, being a sector dominated by the poor class; the financial institutions are advised not to charge too much profit from farmers and relaxation should be awarded in this regard to the best possible extent. They are also advised to eliminate or reduce the collaterals and other securities required against the price to be paid by farmers.[667] These requirements are more

---

[666] Muhammad Faheem Khan, *Islamic Future and their Markets, With Special Reference to their Role in Developing Rural Financial Market*, Paper No.32.p.41.

[667]These collaterals are of a wide variety i.e. real estate, automobiles, cash accounts, investments, insurance policies, valuables and collectables, future payments, gold, ornaments etc. Most of the financial institutions prefer primary collaterals (liquid assets) over secondary collaterals (illiquid assets) as the liquidation valueof an asset decreases as the asset becomes more illiquid. (Johan F. M. Swinnen, Hamish R. Gow, Agricultural credit problems and policies duringthe transition to a market economy in Central and Eastern Europe, Food Policy 24 (1999),pp 21–47www.ruralfinance.org/.../1217526012269_agricultural_credit_problems_in_ECA_region.pdf -(accessed March,2013)However, in case of agriculture sector, the immovable property is favored by the financial institutions. In some countries' financial institutions, the required value of such collaterals is very high and hence beyond the reach of farmers. Majority of these farmers possess the lands as tenants and hence not legally authorized to mortgage such lands and very few of them have their own land.(*Improving Agricultural Microfinance Barriers to the Supply of Agricultural Llending in the Philippines*, Final Draft April, 2009,(This study was undertaken by the Innovations for Poverty Action (IPA) with support from the Hanns Seidel Foundation/Germany (HSF) which is

often than not bring difficulties for farmers to get financing facility from financial institutions. Majority of farmers shows their disinclination to accept securities in the *Istisnā'* contract. The following graphical presentation authenticates the same fact.

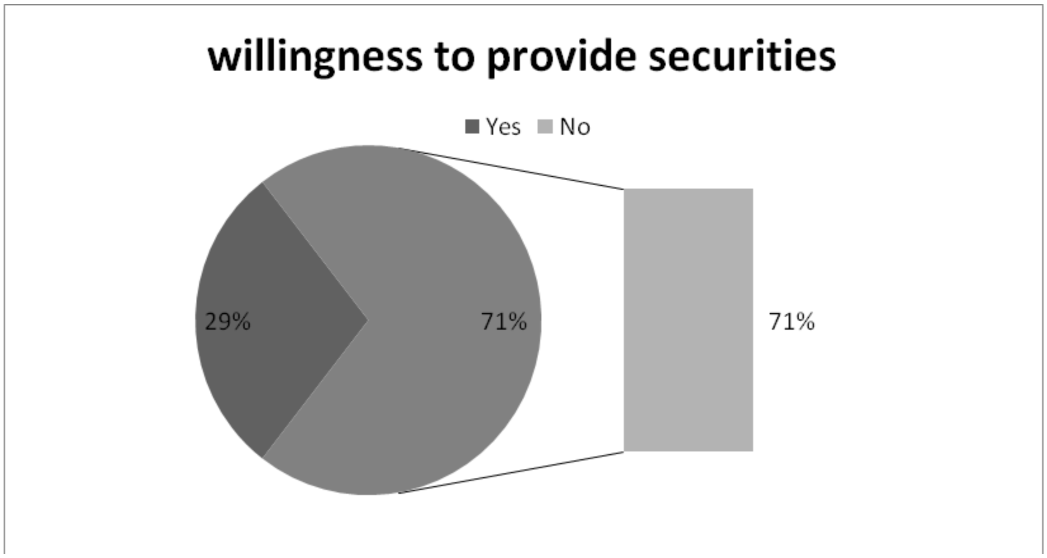


Figure 44: Willingness to provide securities

The data clearly indicates that 71% of farmers are against the requirements of collaterals while 29% favor the same. Unlike the previous groups, the latter group belongs to middle and upper class, and therefore, having the ability to furnish securities.

It is permissible for the Islamic banks and financial institutions to appoint the farmer as their agent by concluding a separate and independent contract of agency with them. This is the most suitable way especially when the contact of *Istisnā'* is applied for house financing or even project financing. The reason is that it is an extremely difficult job for the Islamic bank to supervise the manufacturing or construction process itself, and its practical involvement is not possible in the real sense. It is the duty of the farmer, after being appointed as an agent of the

---

financed by the Federal Ministry of Economic Cooperation and Development (BMZ) under the joint project: "Microfinance Capacity Building Program," in partnership with the Ninoy and Cory Aquino Foundation (NCAF), formerly the Benigno S. Aquino, Jr. Foundation (BSAF), and the PinoyME Foundation (PMF)). http:// www.poverty-action.org (accessed January,2013).The report of Agricultural Census2000 shows that only 37 percent farmers of the rural areas have their own land while 61 percent of these land-owning households owned fewer than five acres, or 15 percent of total land.(Mazhar Arif, Agriculture And Food Security In Pakistan, Thematic Paper,p.13.

bank to supervise the manufacturing or construction process to ensure that the manufacturer or constructor is working as per requirements, and the commodity is produced according to the specifications mentioned in the contract.[668] However, the empirical data received from the respondents shows that majority of farmers are not willing to opt customary agency. The following graphical presentation may draw the whole picture.

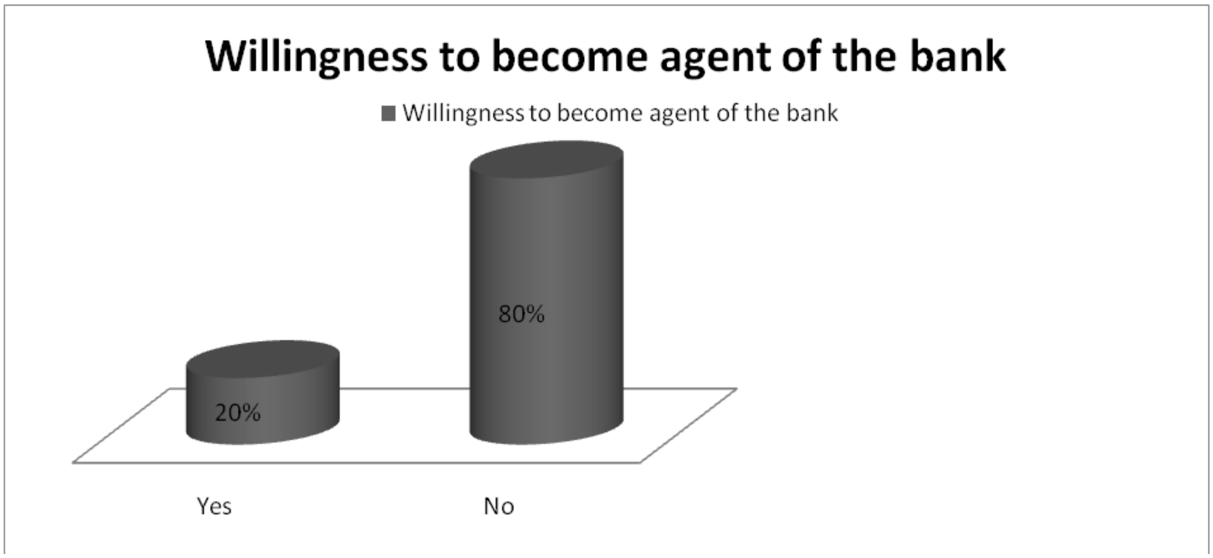


Figure 45: Willingness to become agent of the bank

The data clearly indicates that 80% farmers are not ready to become agents of the banks (as for as the contract of *Istisnā‘* is concerned). There are many reasons for the lack of farmers' interest. Firstly, unlike *Salam* the subject matter in the contract of *Istisnā‘* is always a particular commodity, required to be manufactured by a manufacturer. In case of agriculture, such commodities are usually manufactured in industries which are not usually in the access of farmers. Secondly, such industries manufacture commodities according to approved standards of quality, and therefore, there is no need to ensure that the commodity is produced according to the specifications mentioned in the contract. Thirdly, in the transaction of *Istisnā‘* the structure of agency contract is complex in nature, and hence, difficult for an illiterate farmer to understand.

---

[668]Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transactions*, p.133.

Fourthly, according to Islamic commercial law an agent can charge fee for his agency.[669] The Islamic banks and other Islamic financial institutions are not ready to pay such fee, while the farmers, on the other hand, are not ready to provide services free of cost.

It is pertinent to mention that the financial institution should treat this sector of agriculture through special financing schemes, different from that of other sectors in term of profit ratio on the commodity, procedure of the transaction, payment of collaterals after the farmers purchase the commodity, appointment of the customer as an agent for the purchase of the commodity, periods for installments, amount payable in each installment, recovery procedure etc. As a policy issue, whenever the Islamic banks want to appoint a farmer as its agent for the purchase of the commodity, the remuneration for agency must be given to him. Such cost on farmer's remuneration should not be included in the cost of the commodity under any circumstances. The financial institution must purchase the commodity from the manufacturer on subsidized by price. Such discounts must be passed to the farmer and hence the price may be decreased further. In addition, the State is under obligation to provide substantive subsidies on agricultural commodities manufactured under *Istisnā'* transaction. However, the commodities which are used local farming should be subsidized on priority basis. If the transaction is applied in its real philosophy as discussed by the classical and contemporary Muslim jurists, it will turn the transaction viable not only for Islamic banks and financial institutions but also for the poor famers of this country, especially those residing in the rural areas.

5.3.6 *Ijārah* (leasing) Based Model and Financing Agriculture

5.3.6.1 Theoretical Background of *Ijārah*

The fact whether the ownership of a commodity is transferred to the transferee or not in exchange contracts, Islamic commercial law divides the transactions into two types i.e. sale and lease. In the previous the ownership is transferred to the transferee while in the latter case he enjoys only usufructs of the commodity. The basic philosophy behind this division is to help out

---

[669] Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol-5, p.4058.

those people who are in need of a commodity on contemporary basis but not in position to purchase the same. This later arrangement is known as *Ijārah* (leasing)

The word "*Ijārah*" is an Arabic word, equivalent of the English word "lease" and means "to give something on rent"[670] Here the word "something" denotes benefits and services. As for as the technical meaning is concerned, the jurists have different understanding of the transaction. According to Ibn Qudāmah al- Maqdisī "it is the sale of usufructs".[671] In view of Imām al-Kāsānī, "it is a contract on usufructs for a known consideration"[672] Muhammad Taqi Usmani, a contemporary Muslim scholar gives a very comprehensive definition of the transaction by saying "it is a contract to employ the services of a person on wages or to transfer the usufructs of a particular property to another person in exchange for a rent claimed from him".[673]

The legitimacy of the contract of *Ijārah* can be established from the Holy *Qur'ān*, *Sunnah* and *Ijma'*. According to the Holy *Qur'ān*, "And if they suckle your offspring, then give them their recompense."[674] The proof for the transaction can also be cited from another verse" Said one of the (damsels),"O' my father: engage him on wages, truly the best of men for thee to employ is the man who is strong and trusty"[675]. According to *Sunnah "*If someone hires a person, let him inform about the wages he is to receive".[676] According to Ibn Rushd, the author of *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, all fiqh schools are unanimously agreed over the legitimacy of this transaction.[677]

Islamic law divides *Ijārah* into two classes i.e. *Ijārat-ul- Asyā* and *Ijārat-ul- Ashkhās*. The previous refers to a situation where a person transfers/lends his asset to another against some rentals for a specific period. In other words, giving of something on rent, calls *Ijārat-ul- Asyā.*[678] *Ijārat-ul- Ashkhās* on the hand means hiring of someone services against specified wages mentioned in the beginning of the contract. *Sharī'ah* has described certain rules and regulations

[670] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.157.
[671] Ibn Qudāmah al-Maqdisī, *Al-Kafī*, Kitāb-al- Ijārah, vol.2, p.300.
[672] Kāsānī*, Bādā'i'al-Sanā'i'*,vol.4, p.256.
[673] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, pp.157-158
[674] *Qur'ān*, 65:6.
[675] *Qur'ān,*28:26.
[676] Shawkānī, *Nayl al-Awtār*,Kitāb-al-Ijārāt, vol.5, p.331-332.
[677] Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*,Kitab-al-Ijārāt, vol.2, p.387.
[678] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.157.

for both these typical kinds of *Ijārah*. However, in the present discussion the rules for *Ijārat-ul-Asyā* will be focused more than those of *Ijārat-ul- Ashkhās* owing to the fact of their relevancy for Islamic banks and other Islamic financial institutions.

Like other transactions, Islamic commercial law has described numerous rules and regulations for the validity of *Ijārah*. Among these, the subject should not be perishable or consumable in nature owing to the fact that in the contract of *Ijārah* ownership does not transfer; and the property is returned to its owner at the end of the transaction.[679] Therefore, the lease cannot be effected on money, eatables (wheat, rice, maize etc.), fuel and ammunition etc.[680]similarly, the purpose of the transaction should be lawful and known to the concerned parties from the very inception of the contract.[681] In case where such purpose is not determined, the customary practices has to be followed; provided the later are recognized by the basic principles of *Sharīʻah*. In addition, the subject matter will always remain at the risk of the owner and in case any harm or loss caused by the factors beyond the control of the lessee e.g. earthquake, storm, flood etc, it must be borne by him.[682] However, this principle does not cover the cases of negligence, misconduct and breach of the contract on the part of the lessee. Moreover, the liabilities related to the ownership of the property should be borne by the lessor e.g. property tax, insurance cost, major maintenance etc; while the liabilities related to the use of the property should be the responsibility of the lessee e.g. water bills, electricity bills, gas bills etc. But by mutual free consent, the concerned parties can change their liabilities. Besides, the rentals should also be determined at the very inception of the contract. It may be fixed for the whole period of lease or may be fixed verily for different phases of the whole period or may be fixed according to a known future bench mark etc.[683] In addition to above rules and regulations, *Sharīʻah* also has prescribed some principles for the termination of the transactions. For example the contract of *Ijārah* is not binding in nature, and therefore, any party can terminate it at any time without giving any prior notice to the other party. It means that mutual free consent of the concerned parties is not necessary for the termination of the transaction. However, Sarakhsī has a

---

[679] Ibn Qudāmah al-Maqdisī, *Al-Kafī*,, Kitāb-al- Ijārah, vol.2, p.301.
[680]Kāsānī*, Bādā'i'al-Sanā'i'*,vol.4, p.257-258.
[681]Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol.5, p.3869.
[682]Kāsānī*, Bādā'i'al-Sanā'i'*,vol.4, p.308.
[683] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.161.

different opinion over the issue. In his view, the contract of *Ijārah* is a typical kind of exchange contract, and hence, cannot be terminated without the consent of all related parties.[684] As for as the contemporary business environment is concerned, this view can be preferred in order to protect interest of any of the contracting party whenever it comes under the threat due to the termination of the transaction. Similarly, the transaction comes to an end at the destruction or permanent defect in the leased asset. However, in case of temporary defect, the contract will be resumed at the removal of the same. Moreover, death of lessor and lessee does not cause termination of the transaction and the corresponding legal heirs will replace the concerned party.[685] The expiry of time, mentioned for the lease agreement, also causes termination of the contract.

5.3.6.2 *Ijārah* as a Financing Tool for Agriculture

As mentioned earlier, that *Ijārah* can be divided into two classes i.e. *Ijārat*-*ul*- *Asyā* and *Ijārat*-*ul*- *Ashkhās*. The Islamic banks and other Islamic financial institutions apply the previous one (*Ijārat*-ul- *Asyā)* for financing purposes while they have no concerned with the latter one. Therefore, in the banking context *Ijārah* means the process by which usufructs of a particular property is transferred by the Islamic bank to a customer against a specified rent claimed from him. Due to this fact, only *Ijārat*-*ul*- *Asyā* (leasing of asset against specified rentals) can be used for financing agriculture, both in crop and non crop activities. This may be the best possible alternate of the concept of leasing used by the conventional financial institutions for agricultural finance.

Before embarking on the application *Ijārat*-*ul*- *Asyā* for the development of agriculture, particularly local farming in rural parts of the country; it is appropriate to point out those requirements of agriculture which can be fulfilled through this mode. These requirements include the following

1. Agricultural equipments and implements like trailers, threshers, power filler, power and boom sprayers, plough, cultivators, riggers, drills, rotovators, diggers, cotton picker, saw machines for crate making, press machine for wheat straw and

---

[684] Sarakhsī, *Al-Mabsūt*,Kitāb-al-Ijārāt, vol.5, p.80.

[685] Ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, Kitāb-al-Ijārāt, vol.2,p.407.

dry fodder, chisel ploughs, potato planter, sugar cane planter, rice trance planter, self propelled reaper for harvesting wheat and rice crops etc.[686] Being major tools for local farming , the lower and middle class of farmers are equally in need of such equipments for the smooth running of their agricultural activities. Some of these equipments are very expensive in nature, and therefore, cannot be purchased by farmers themselves.

2. For the proper irrigation system, farmers are in need of tube wells, turbine, sprinkle or drip irrigation system, water management, solar energy plants, pumps etc. The proper irrigation system if properly channelized; can play a vital role in the increase of agricultural production.

3. Farmers are for all time in need of transport facilities for the purpose to carry their products to the local market on time. Therefore, they are always in tense need of refrigeration vans, farm cooling tanks, motorcycles for milkmen, small pickups, mini trucks and chiller carriers, etc.[687] The provision of transportation plays a vital role in the development of the agricultural sector, particularly in rural and remote parts of the country.

The contract of *Ijārat-ul- Asyā* can be effectively applied for the fulfillment of all these requirements. For example the requirements which are mentioned in category No.1 can be met where the Islamic banks/ Islamic financial institutions acquire the asset from the supplier at the request of the farmer. After getting the asset of the required quality and quantity, it is the responsibility of Islamic financial institutions to hand over the asset to the farmer through actual or constructive way as the later is also recognized by Islamic commercial law. In addition, the time of delivery should be explicitly mentioned in the contract, and if the Islamic bank fails to deliver the asset accordingly, then it cannot charge any rent from the farmer for that duration, and the agreed rent should also be reduced accordingly. At this very point, the difference

---

[686]*Guidelines on Islamic Finance for Agriculture* , Islamic Banking Department, State Bank of Pakistan, p.5.
[687]Ibid, p.5.

between conventional leasing and *Ijarah-al- Asya* comes to the spot. The implements and equipments which are mentioned in this category for farm financing usually not too much expensive in nature, therefore, it is better that the Islamic bank should purchase the commodity by itself, and thus, will become the absolute owner of the asset, and will then lease the asset to the farmer. The empirical data shows that majority of farmers like such kind of arrangement for obtain heavy agricultural equipments owing to the fact that they cannot afford to purchase the same by themselves. The follow graphical presentation indicates the same fact.

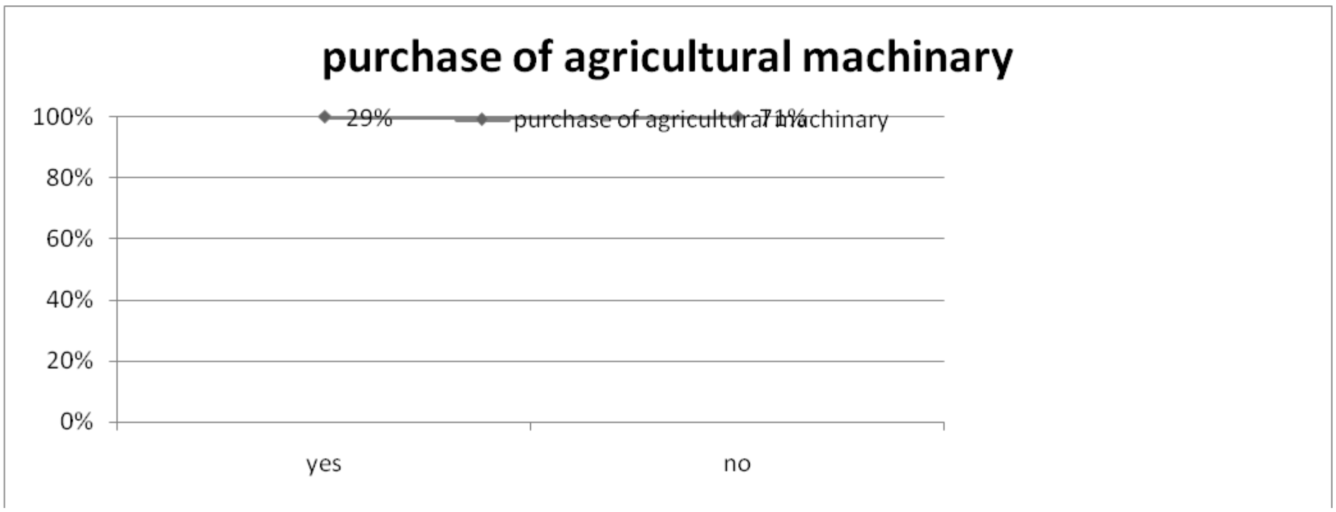


Figure 46: Purchase of agriculture machinery

The graphical presentation clearly shows 71% percent of the respondents are in favor of such arrangement. The data also clearly indicates the expected role of the transaction for the development of agricultural sector. However, majority of the respondents have lack of information about getting such equipments from the Islamic financial institutions on the easiest installment basis. The following graphical presentation is an enough evidence for the lack of awareness.

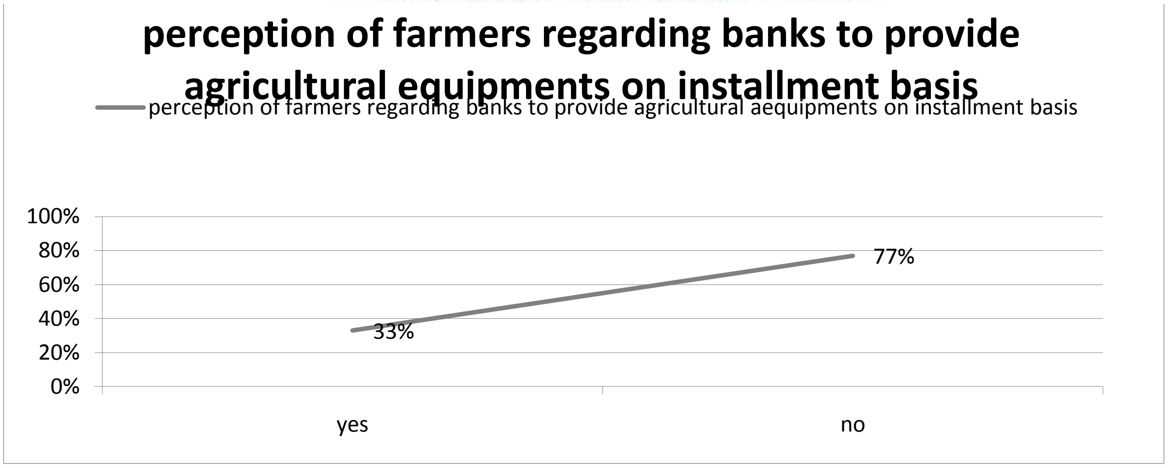
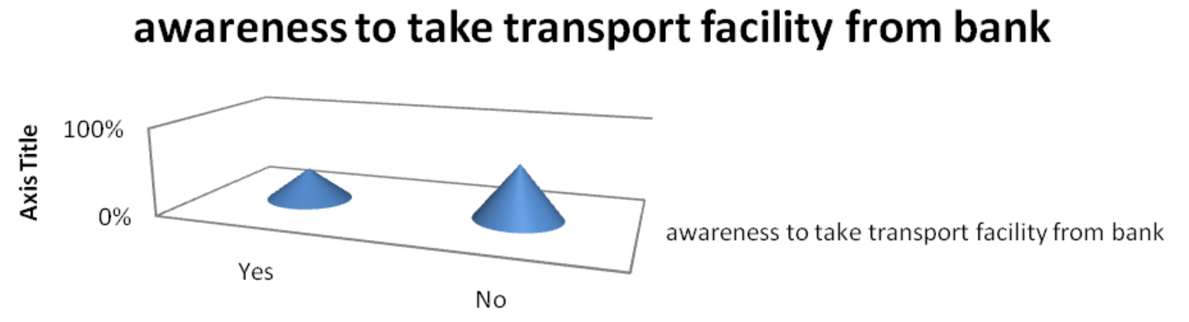


Figure 47: Perception of farmers regarding banks to provide agriculture equipments on installments.

It is required for Islamic financial institutions to advertise and market their products properly in order to create awareness among farmers regarding the possible ways of agribusiness. Such awareness may be created through seminars, workshops, training and other contemporary techniques for marketing. More emphasis is needed to be given on rural agricultural finance. The State Bank of Pakistan can also play a vital role in this connection.

The requirements related to transport financing in category No.2 and category No.3 can also be fulfilled through application of *Ijārat*-*ul*- *Asyā*. In this situation too, the Islamic financial institution may purchase the required commodity from a supplier and then leased out the same to the farmer against specified rentals. All risks related to the ownership of the leased asset must be born by the financial institutions while the risks related to its use will be born by the farmer. Here the same procedure will be followed as mentioned in category No.1 with some minor changes where deem necessary. However, the lack of farmers' awareness is the main hurdle for availing of such facility. During the collection of data it is observed that majority of respondents have lack of awareness that a financial institution can provide the transport facility. The following graphical presentation may be cited as solid evidence.



	Yes	No
awareness to take transport facility from bank	37%	63%

Figure 48: Awareness to take transport facility from bank

The graphical presentation shows that 63% farmers do not know about the provision of transport financing provided by the Islamic banks and other Islamic financial institutions. This actuality put the agribusiness on back foot and less viable for the development of agricultural sector.

But facts show that *Ijārat-ul- Asyā* does not benefit lower class of farmers to a desirable and satisfactory extent. The reason is that all requirements which are mentioned under category No.1 usually expensive in nature, and therefore, their purchase is avoided by such farmers. Empirical study reveals the same fact (as mentioned in the above graphical presentation) as 77% of farmers do not have financial resources to purchase heavy agricultural machinery and equipments. This result is quite logical owing to the fact a farmer who is unable to buy the basic needs for agriculture e.g. seeds, fertilizers, herbicides, weedicides, insecticides, manual sprays etc, can lease or purchase expensive agricultural implements and equipments e.g. tractors, thrashers, mini trucks, vans, power tillers, rotavators, diggers, press machines for wheat straw and dry fodder etc. Similarly the requirements which are mentioned in category No.2 and category No.3 belong to the middle and upper class of farmers. Large lands require tube wells, turbine, water management, solar energy plants, pumps etc and such big lands are owned by land lords or upper middle class. Similarly large lands produce excessive production, and hence, need transport facility for their immediate transportation to the local market. The lower class of farmers, on the other hand, requires shovel, fork, hand fork, hoe, rake, wheel barrow, watering can etc. They are neither in need of heavy agricultural equipments nor need transport facility. Therefore, some

amendments must be accommodated in the existing proposed financing models in order to make it more viable for lower class and lower middle class of farmer. It is therefore suggested that Islamic banks and Islamic financial institutions first purchase all basic machinery and tools from the local market, and thus made a pool of all these assets. After having such assets, the Islamic bank transfers these to a farmer on lease basis. For the easiness of a farmer, the Islamic banks should have to lease out these equipments on the basis of hourly or daily rentals. During frequents visits, it is observed that some of the local residents also own such assets particularly tractors, thrashers, mini trucks etc. They also rent out their tools (particularly tractor) to farmers on the basis of hourly rentals. It is, therefore, suggested for the Islamic banks to follow the same mechanism and charge rentals comparatively less than the rentals charged by such owners of the asset from the local farmers. But while doing so, they must follow the principle "the institution does not finance primarily the farmer to get profit but finance him for the purpose to facilitate him". In addition, the financial institutions are also advised not to insert penalty clause in the contract of *Ijārah* in order to minimize farmers' default. As majority of farmers cannot afford, the securities's requirement for the provision of the facility should be eliminated at all or reduced to great extent. The following graphical presentation shows that majority of farmers are not in position to furnish the required securities

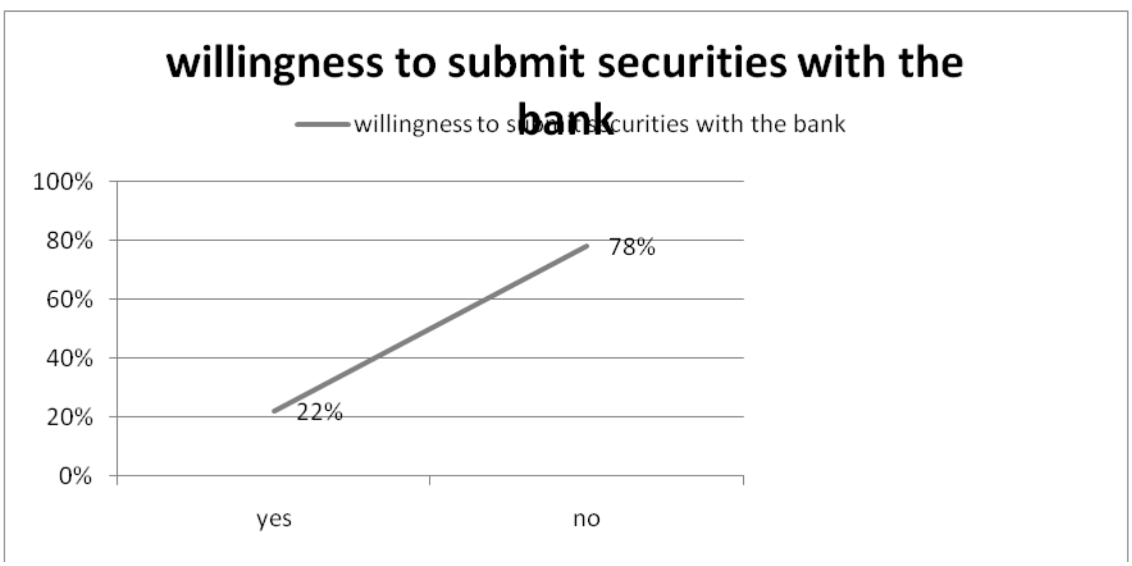


Figure 49: Willingness to submit securities with the bank

The graphical presentation shows that 78% of farmers do not have the required collaterals, and hence, it is quite possible that they avoid banking services owing to the same reason. It is

therefore advised that some other ways must be found for the solution of the problem i.e. selected customership, personal guarantee, proper recovery mechanism etc. Similarly, the institution and farmer should go for typical kind of *Ijārah* known as *Al- Ijārah-Almuntaheya-bi-Tamleek* (a lease that comes to an end with sale transaction). In this type, the farmer becomes an ultimate owner of the asset after paying all rentals equal to the price of the same asset. The empirical research shows that majority of farmers like to become owner of the leased asset. The following graphical presentation of the collected data sows explicitly their desire for ownership.

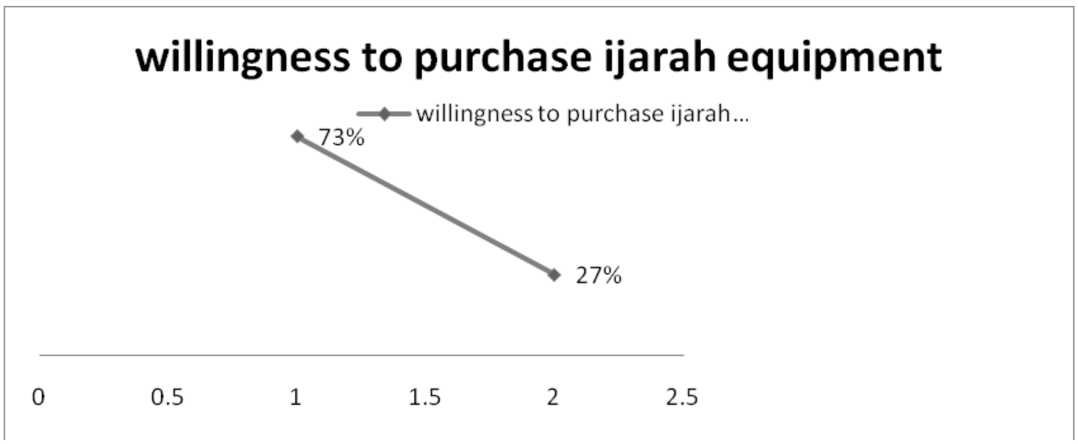


Figure 50: Willingness to purchase ijarah equipment

While summarizing the above discussion it can be easily concluded that if *Ijārah* in its true spirit, rules and regulations described by Islamic commercial law, then it can be effectively used for the development of agricultural sector, particularly in rural parts of the country. The farmers' communities have the same opinion when they were asked regarding the same. The following graphical presentation, drawn from the collected data, describes farmers' opinion more explicitly.

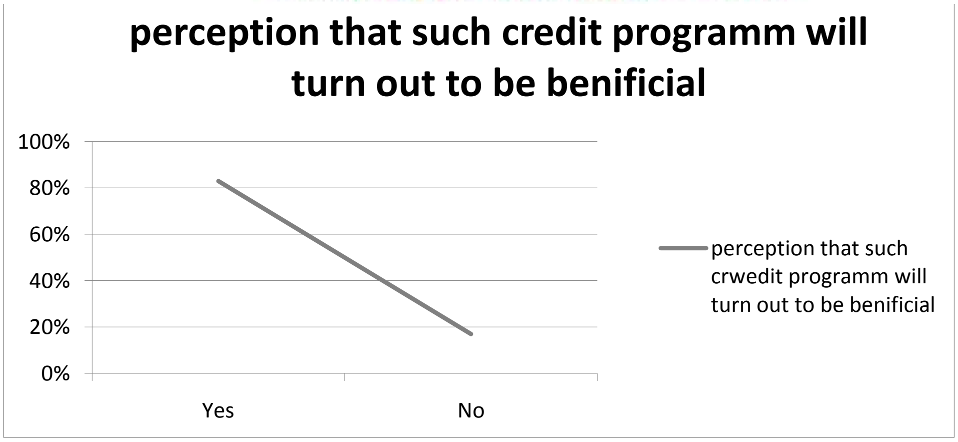


Figure 51: Perception that such credit program will turn out to be beneficial

Ijārah Based Model

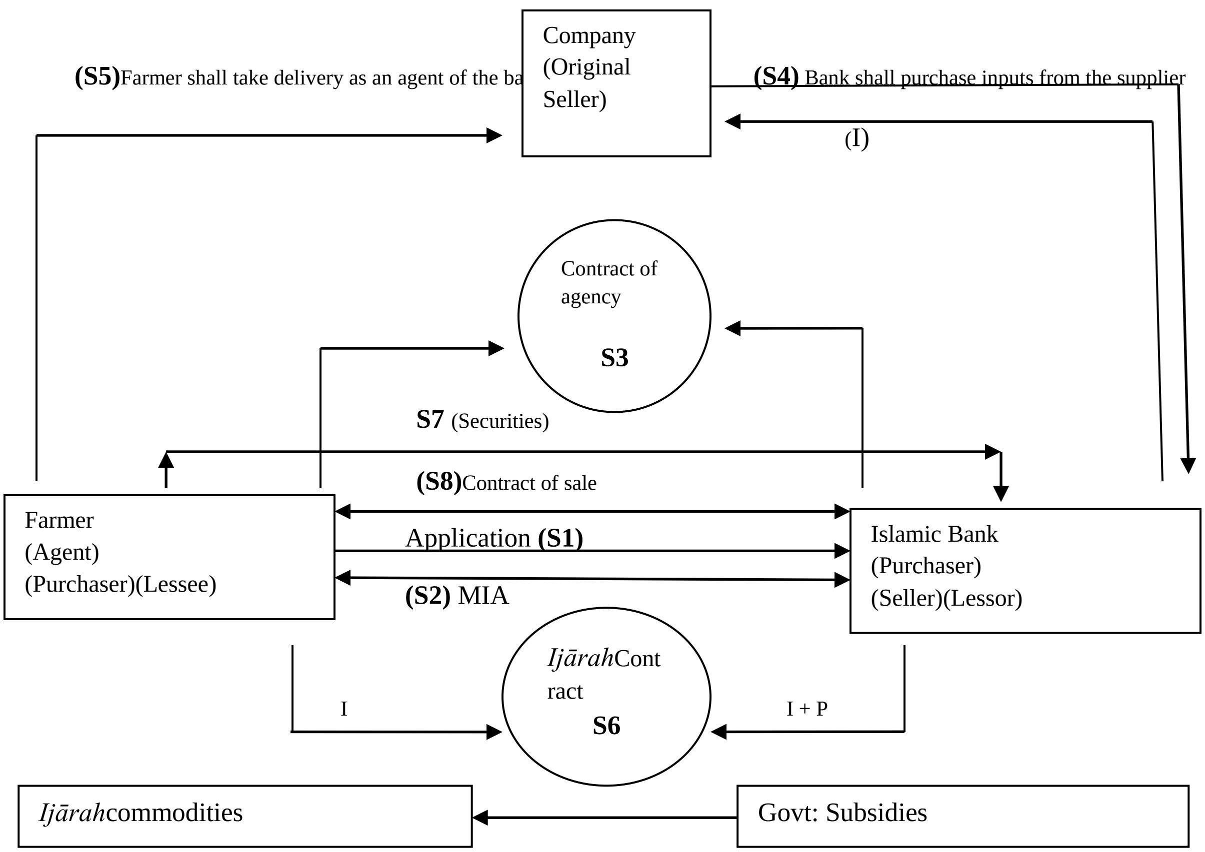


Figure 52*Ijārah*based Mode

5.4 Conclusion

Agriculture is one of the most important means employed by most of the developing countries to cater to their food requirements. Since most of these nations are labor intensive, agriculture helps provide a significant source of the employment to the over populated masses. In Pakistan, 43 percent of the labor force gets its livelihood from the agriculture sector contributing 23 percent to its GDP. However, the financial institution ignored this important sector and concentrated on other more profitable areas of business. The farming community comprises of the large, medium, and small farmers of which, as is usually the case in developing countries, a large number of small farmers own only a small share of cultivable area. The majority of the population related to the agriculture sector belongs to the poor class of society.

A great majority of these small farmers are therefore require additional financial resource to cater to their needs arising at different phases of the harvesting cycle. The cycle starts with the farmers requiring financial resources to procure fundamental agriculture inputs such as fertilizers, seeds, herbicides, ploughing tools etc. During the mid and end of the harvesting cycle, more funding is necessitated for the purchase of pesticides, and various agricultural tools. Since resources are required throughout, a vast majority of small farmers constantly struggle to make ends meet. To manage their operations they have to borrow from different entities such as individuals, banks, other financial institutions, and government i.e., from both formal and informal credit sources. Islam strictly forbids *Ribā*. *Sharī'a*h, restrains Muslims from securing any loan, whether from formal or informal sources, based on interest. To be *Sharī'a*h compliant, Muslim farmers, are forced to fulfill their agricultural needs from other sources of financing acceptable and endorsed by Islamic financial system. Being a complete code of life, Islam presents a comprehensive and easy way for farmers, Islamic banks and Islamic financial institutions to enter into various commercial transactions which are viable for stake holders; and also indispensable for the development of agricultural sector both for crop and non -crop activities. These transactions can be divided into trade based modes, such as, like *Murābahah, Musāwamah, Salam, andIstisnā'*; participatory modes, such as, *Mushārakah, Diminishing Mushārakah, Musāqah,* and *Muzāra'h* ; rent based modes, such as *Ijārah* which can be further divided into *Ijārat-ul-Ashkhās and Ijārat-ul-Asyā*. All these transactions have a potential to help a farmer to fulfill his agricultural needs that start from basic agricultural inputs like seeds,

fertilizers, herbicides, weedicides, and basic agricultural tools and ends with heavy agricultural machinery like tractors, thrashers, and harvesters. These can also be used effectively for the development of other sectors of agriculture like livestock, fish farming, dairy farming, poultry farming, and horticulture. However, the intended results from all these modes of Islamic finance option can be achieved with a condition if some alterations (in the light of survey conducted)are made in the existing structure employed by the Islamic banks and other Islamic financial institutions. Firstly, the existing procedure described by *Sharī ʻah* Standards (AAOIFI) is very complex in nature and should be replaced with a simple procedure understandable by the farmers who desperately need the financing but may find it difficult to understand the complicated process currently in place. Secondly, these institutions need to earn less profit from farmers as compared to other general customers in concert with the basic philosophies of cooperation and development of society, aimed by the Islamic financial system. Thirdly, local farming will be concentrated more in terms of financing than other sectors of agriculture like livestock, dairy farming, fish farming, horticulture, poultry farming etc. Fourthly, ground realities are against the provision of securities as majority of farmers belong to lower class, and consequently, are not in position to provide securities and other forms of collaterals. Therefore, some other techniques should be followed by the financial institution for the protection of their liquidity. The best possible solution in this regard may be the provision of personal or group based securities. Fifthly, very simple and accurate procedure will be followed for the provision of financing facility and the best possible efforts will be made for the reduction of transactional costs. Sixthly, Majority of farmers (respondents) do not accept the arrangement of customer agency and unwilling to become agent of the bank. The possible solution is that any other farmer, not the customer, of the same locality can be appointed by the bank as its agent.

CHAPTER 6

ANALYSIS OF SHARĪ‘AH ISSUES IN THE CONTEMPORARY GUIDELINES FOR FINANCING AGRICULTURE

6.1 Introduction

In 1970s, some major steps have taken by the government of Pakistan for the development of Islamic banking and finance.[688] These steps have paved a way for the rapid growth of Islamic banking in the country, and after achieving tremendous results in the commercial markets, further expansion of the banking services to other sectors is advised by the State Bank of Pakistan. Among these sectors, agriculture has given priority over other sectors, for being the most important source of food. In order to facilitate, the Islamic financial institutions in general, while the other conventional banks in general, the Agricultural Credit Department of the State Bank of Pakistan has issued various guidelines on financing agriculture. These guidelines include the following

- Guidelines on Islamic Finance for Agriculture.[689]
- Guidelines for Horticulture Financing.[690]

---

[688]In 1970 some somber efforts were done for the growth of Islamic banking and finance, but no mentionable results were secured. However, in 1980s some proper legislation had been made for interest free banking and many existing laws were reviewed like Companies Ordfinance,1984, Negotiable Instrument Act,1882, State Bank Act and Recovery of Loans Laws etc. The main rationale was to mould all these earlier legislation according to the principles of *Sharī`ah.* Some other steps were also taken in the same era. For instance, issuance of interest free instruments like PTC (Participation Term Certificates which was later on replaced with TFC) and NIB (Non-Interest Based Instruments), opening of interest free counters in all conventional banks, introduction of the contract of *Mushārakah* (Islamic law of partnership) in its various applicable forms. In 1990s, a noteworthy and historical decision was made by the Federal Shariat Court on 23rd December, 199; declaring all commercial dealings containing interest null and void abinitio with effect from 30th June, 2001. A separate Islamic Banking Department was established by the State Bank of Pakistan to look after the development of Islamic financial institutions in the country and take some concrete measures for their smooth running in the commercial markets. In the start of 21st century, Commission for Transformation of Financial System was also constituted by the central bank. In addition, it also set up a Task Force for the purpose to forward suggestions for the elimination of interest from Government financial transaction……………………. For more details Khawaja Amjad Saeed,*Islamic Banking in Pakistan: A Review of Conventional and Islamic Banking*, Proceedings of 2nd International Conference on Business Management *(*ISBN: 978-969-9368-06-6), *pp.7,8,* umt.edu.pk/icobm2012/pdf/2C-95P.*pd*/(accessed: 21st August, 2014).

[689]*Guidelines on Islamic Finance for Agriculture* , Islamic Banking Department, State Bank of Pakistan, p.5.

[690]*Guidelines for Horticulture Financing*, the Agricultural Credit Department, State Bank of Pakistan.

- Guidelines for Poultry Financing.
- Guidelines for Fisheries Financing.[692]
- Guidelines for Livestock Financing.[693]
- Guideline for Financing Scheme for Small Farmers.[694]
- Guideline on Frequently Asked Questions (FAQs) On Agri Financing.[695]
- Handbook on Best Practices in Agri/Rural Finance.[696]
- Prudential Regulations for Agriculture Financing.[697]
- Definition of Agricultural Terminologies.[698]

The list shows the zeal having by the central bank for the development of agriculture sector, particularly the development of local farming which is hub for the lower class of farmers. However, the given list is not comprehensive in nature and there are many other policy documents issued by the Agricultural Credit Department of the State Bank of Pakistan, facilitating all financial institutions of the country in making policies for financing agriculture. But as for as the present work is concerned, only those guidelines will be critically analyzed which are directly or indirectly related to Islamic agricultural finance. It is pertinent to mention that critical analysis from the *Sharīʻah* perspective will be carried out primarily in the light of

[691]*Guidelines for Poultry Financing*, Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2007/Draft-Guidelines-Poultry-Financing.pdf (accessed: 28th February, 2014).
[692]*Guidelines for Fisheries Financing*, Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2007/Guidelines-for-Fisheries-Financing.pdf (accessed: 28th February, 2014).
[693]*Guidelines for Livestock Financing*, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2006/Guidelines_Livestock_C1.pdf (accessed: 28th February, 2014).
[694]Financing Scheme for Small Farmers, Agricultural Credit Department, State Bank of Pakistan (accessed: 28th February, 2014).
[695]*Frequently Asked Questions (FAQs) on Agri Financing*,Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/ACD_FAQs.pdf (accessed: 28th February, 2014).
[696] Handbook on Best Practices in Agri/Rural Finance ,Agricultural Credit Department .State Bank of Pakistan,pp15-16 http:// www.sbp.org.pk,accessed December 25, 2012).
[697]*Prudential Regulations for Agriculture Financing*, (Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan, p.6, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

[698]*Definition of Agricultural Terminologies*, Agricultural Credit & Microfinance Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/Acd_Definitions.pdf (accessed: 21st August, 2014).

tremendous work of classical Muslim jurists. But it does not mean that the work of contemporary Muslim jurists will not be resorted at all. Both classical and contemporary literature of Islamic commercial law will be used while analyzing these guidelines.

6.2 *Sharī'ah* Issues in the Existing Guidelines for Financing Agriculture

Before deciding whether these guidelines are sufficient or not for the development of effective agricultural financing, some questions must be answered, such as, are these guidelines based purely on the principles of Sharī'ah? Are these guidelines enough to cover the vast spectrum of Islamic agricultural finance? Can these guidelines be used for the development of such models which are feasible and practicable for the development of the agricultural sector? Are these guidelines helpful in realizing those objectives projected by Islamic financial system? Are the Islamic banks, Islamic financial institutions and conventional financial institutions following these guidelines in their true spirit? The main purpose of the present work is to answer these questions with strong evidences.

6.2.1 The Issue of Interest

The Muslim farmers are prohibited by Sharī'ah (Islamic law) to get interest-based loan. There are many verses of the Holy *Qur'ān* and *Sunnah* of the Holy Prophet(SAW) that prohibits interest-based transaction in any form. For instance, in the Holy *Qur'ān Allāh*, the exalted, says "O Ye Who Believe! Fear *Allah*, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and His apostle. But if ye turn back ye shall have your capital sums: deal not unjustly and ye shall not be dealt unjustly.[699] In another verse the Lord of Universe says "That they took Ribā (usury), through they were forbidden and that they devoured men's substance wrongfully. We have prepared for those among men who reject faith a grievous punishment".[700] The hadith of the Holy Prophet (SAW) confirms the same prohibition. From Jābir, may *Allāh* be pleased with him, said: "The messenger of *Allāh* (SAW) has cursed one who charges Ribā, he who gives it, one who records it, and the

[699] *Qur'ān* 2:278-279.
[700] *Qur'ān* 4:161.

two witnesses, and he said, "They are equal".[701] Abdullah Ibn Masood narrates that the Holy Prophet (SAW) has said "*Ribā* has 73 doors or 70 grades; least serious is equivalent to committing adultery with his own mother".[702] According to Allma Syed Muhammad Ibn Ismaeel Alsanani, the leaned author of the well renowned book Subul –al- Salam, all Muslim jurists have consensus over the prohibition of Ribā with some differences in minute details.[703]

The issue of interest is the main problem in the existing structure of agricultural finance. Although the guidelines issued by the State Bank of Pakistan do not use the term "interest" directly, however, the rules mentioned therein are almost similar to those used by the conventional financial institutions for the determination of interest. For instance, the guideline issued by the State Bank of Pakistan on Islamic agricultural financing states

> "Under Islamic Modes of financing IBIs are prohibited to charge any *Ribā* or interest on their Financing. However, it can share the profit/loss being an investor in the business or can charge rentals and other service charges at pre agreed rates on case to case basis. Such incomes are based on financing policy of the IBIs and regulations of SBP".[704]

The statement clearly indicates that the central bank does not bind the Islamic financial institutions not to charge interest rather its just gives a sweeping statement that Islamic banking institutions are prohibited by Sharī'ah to use various Islamic modes for charging interest. In another guideline, known as "Financing Scheme for Small Farmers" issued by the State Bank almost the same statement has been given i.e. ""Bank shall determine mark-up on the basis of KIBOR and their cost of funds in line with their credit policy."705The statement shows unwillingness of the central bank to impede financial institutions from charging interest on financing agriculture. After such authorization how it is possible for financial institutions not to charge interest on agricultural financing; especially when its whole business is based on the

---

[701]*Muslim*, Hadith No.1597; *Abū Dawūd*, Hadith No.3333; *Tirmidhī*, Hadith No.1206;Ibn Majah, Hadith No.2277
[702] Ibn Majah, Hadith No.2275.
[703]Allma Syed Muhammad Ibn Ismaeel Alsānanī, *Subul –al- Salam*, Urdu Translation by Abdul Qayoom,Sharia Accademy, International Islamic Unioversity Islamabd,First Edition.2004,Bab-al –Riba ,p.86
[704]*Guidelines on Islamic Finance for Agriculture*, the Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.13.

[705]*Financing Scheme for Small Farmers*, Agricultural Credit Department,State Bank Of Pakistan, http:// www.sbp.org.pk (accessed January,2013).

concept of profit maximization. In addition, the banks are directed to determine their mark up on the basis of KIBOR; a bench mark used by the conventional financial institutions for the determination of interest rates. If it is so, then the statement given in the guideline for Islamic agricultural finance i.e. "……………the Islamic bank can share the profit/loss being an investor in the business or can charge rentals and other service charges at pre agreed rates on case to case basis. Such incomes are based on financing policy of the IBIs and regulations of SBP" has no meaning at all.

As a solution to the above mentioned problem, some steps, though rigid in nature, must be taken by the Central Bank. Being a regulatory body, the State Bank should strictly bar the Islamic financial institutions not to charge interest in any form; and in case of violation, some serious actions should be taken against them. Such actions may start from pecuniary punishment to the extent of cancellation of registration. As a matter of fact, the advisory type of guideline may not be a successful strategy to prevent Islamic financial institutions from indulging in interest based transactions, directly or indirectly. They may simply change the term "interest" with "profit" and the term "rescheduling" with "penalty for the default of payment". In addition, it is the responsibility of the Central Bank to urge the financial institution for the active involvement in the business rather than performing just the role of mediator. By following this, the financial institution would be in position to earn profit, in compliance with the principles of Islamic commercial law, rather than charging of interest. Moreover, strategic as well as operational cooperation must be made by the central bank in this regard.

6.2.2 The Issues of Recovery Procedure

The most important issue for a financial institution is the recovery its financed amount along with profit. The proper recovery system ensures development of financing portfolios and consequently the financial institutions opt for the provision of more financing facilities. In case of agricultural, the need for proper recovery system increases owing to the fact that this sector is prone to many natural risks like droughts, floods, hail storms, earthquakes, mudslides, and a multitude of other mishaps. Due to these risks, the financial institutions are very much reluctant

to go for its financing.[706] Besides the natural risk, there are some other risks that further changed the situation from bad to worse. These risks include economic risks, operational risks, social risks, political risks etc.[707]The economic risks include price fluctuations; fall in demand, interest rates, exchange rate etc. These risks are controllable if the governments play due role and bring economic stability in their regions. The operational risks relate to land (e.g. soil contamination), capital (e.g. depreciation), labour (e.g. illness) etc. These risks can also be controlled by the governments through institutional efforts. The social risks ensue from social behaviors including strikes, theft, riots, warfare etc. All these risks can be controlled or curtailed through strong economic, political, and social policies.

Because of all these risks, the State Bank of Pakistan has recommended very rigorous rules and regulations for monitoring and recovery system. According the guideline, issued for Islamic agricultural finance, the Islamic financial institutions are advised to follow some measure in order to develop a proper recovery mechanism. These measures include the following.[708]

1. The Islamic financial institutions are required to follow up their customer and have frequent interaction with them. This will help the institutions to properly supervise the use of advanced amount.
2. The Islamic banks are required to follow the traditional correspondence and letter/ notice based recovery mechanism. Before and after the laps of time of repayment mentioned in the contract, notices and letters will be issued for reminding and warning respectively.
3. The Islamic financial institutions are also advised to follow the guarantors through personal contacts. This will indirectly pressurize the farmers to pay the amount due within the given time.

---

[706] Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes and Instrument: Practical Scenario and Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34,p.50.

[707]Matthias Bickel, Martin Klein, *Rethinking Rural and Agricultural Finance –The African Case*, international Platform, https:// www.rural21.com/.../R21_Rethinking_rural_and_agricultural_finance_0... (accessed: 17th March, 2014).

[708]*Guidelines on Islamic Finance for Agriculture*, the Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, pp.13,14 .

4. In case a farmer fails to pay the amount due, recovery can be made through the intervention of Tehsildar, when the amount financed is decaled as Arrears of Land Revenue, based on Section 4 (7) of Loans for Agriculture Purposes Act, 1973. This declaration can be made by the Collector /Assistant Collector or Deputy Commissioner in case of financing against passbook.
5. The Islamic financial institutions can also file recovery suit in the concerned Banking Courts, having competent jurisdiction.
6. The Islamic financial institution can also recover the amount due from a farmer according to the procedure mentioned in Financial Institutions (Recovery 0f Finance) Ordinance 2001.
7. Any other legal remedy available to an Islamic Financial Institution for the recovery of its liquidity.

In some cases, the financial institutions are authorized absolutely to set up any procedure for the recovery of their liquidity. In a Prudential Regulations for Agriculture Financing, issued by the State Bank of Pakistan, the authorization is made in the following words

> "Banks/DFIs are also encouraged to prepare comprehensive recovery procedures, which should interlaid specify certain triggers for taking specified actions while requiring reasons to be recorded in writing in exceptional cases where specified actions are not being taken."[709]

The above mentioned procedure is not in line with the rules and regulations described by *Sharī'ah* for the recovery of any financial liability. Islamic commercial law presents a recovery procedure which is based on the principle of justice, easiness and human respect. Therefore, *Sharī'ah,* advises creditor to give relaxation to the debtor till a time when the debtor is in a position to make payment. If the debtor is unable to repay the amount at the given time, in special cases, it is advised that the amount may be remitted as a charity. *Qur'ān* says, "And if any debtor be in straitened circumstances, then grant him respite till a time of ease. And that you

---

[709] *Prudential Regulations For Agriculture Financing*,(Updated on 29th January, 2014), Agricultural Credit & Microfinance Department, State Bank of Pakistan,p.6, http:// www.sbp.org.pk/publications/prudential/prs-agriculture.pdf (accessed: 26th March, 2014).

remit it as charity, shall be better for you, if only you knew[710]. The guideline on Islamic agricultural finance, on the other hand, neither provides any provision related to the relaxation in terms of time for repayment nor entire omission of debt. It rather advises the financial institutions to use forceful methods for the recovery of debt. The advises mentioned under category No. 4, Category No.5 and Category No.6, are ways to such forceful recovery of the debt. Similarly, the contract of guarantee in Islamic Commercial is basically a charitable contract (*Aqd al Tabaru'*), and therefore, the guarantor does not take any charges. He has to pay the amount where creditor fails to fulfill his financial liability. However, the advice mentioned under Category No.2 of the guideline requires continuous follow up of the guarantor from the very inception of the contract. This may be a suitable way in conventional financial system where the guarantor charges both debtor and creditor for suertyship. But as the same is not possible in Islamic commercial law, the unstop follow up may irritate the guarantor, and consequently may refuse to continue the guarantee contract.

In order to put the recovery procedure in line with the dictates of Sharī'ah, the rules and regulations mentioned in Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) must be followed for the recovery debt. However, the rules mentioned in the Guidelinefor Islamic Agricultural finance are contradictory in nature to those mentioned in AAOIFI's Standards. For instance, According to Rule No.2/6 of the Standard, the default in payment is established when a normal notice for payment is given to a defaulter (who has not proved that he is insolvent) who fails to pay the debt on its due date.[711] he statement clearly shows that the rule differentiate between solvent and insolvent debtor. The guideline on Islamic Agricultural Finance, on the other hand, does no classify the defaulters in such way and treat them equally. Similarly, Rule No.2/5(a), the financial institution is entitled to follow affairs of a debtor and his financial dealings after his default.[712] It shows that no follow up is required before the stage of default. However, the guideline for Islamic agricultural finance requires the Islamic financial institutions to follow up their customer and have frequent interaction with them from

---

[710]*Qur'ān* 2:281.

[711] *Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI)*, Sharī'ahStandard No.3,Rule No. 2/6, English Version, p.33

[712] Ibid, Rule No.2/5,p.33.

the very beginning of the transaction. In addition, the rigorous rules and regulations for monitoring and recovery system, issued by the State Bank of Pakistan, can also be proved helpful for the recovery of loan advanced. However, the respective *Sharī'ah* advisor must be kept in consultancy, by the Islamic banks and other Islamic financial institutions, before adopting such mechanism for the recovery of loan.

In addition to the above, the other various guidelines issued by the State Bank of Pakistan for financing agriculture do not answer some questions which are directly or indirectly related to the recovery of debt. These questions include, for instance, does the Islamic financial institution stipulate any penalty clause in the contract by virtue of which it can demand any financial compensation from a farmer in case of his default? In case of default, who will bear all legal and other expenses incurred for the recovery of debt? How a defaulter farmer will be blacklisted? If the farmer, entirely at his own discretion, pays an additional amount when setting his debt, then what would be the legal status of such additional amount? In case of natural disaster, how much compenasation will be given to a farmer in repayment time? All these questions have been dealt by Islamic commercial law with minute details, and therefore, should be included in all these guideliens.

6.2.3 The Issues in Eligibility Criteria

The Islamic financial institutions do not provide loan to each and every individual who applies for getting financing facility. They usually opt strict eligibility criterion in order to minimize the risk of default. A closer scrutiny shows that such eligibility standards are settled in such a way that a lower class and lower middle class of farmers cannot fulfill it, and therefore, the financing facilities are provided to upper middle class and upper class of farmers. On the same way some time the financing activities are shifted to corporate clients and individual farmers are ignored. Therefore, more funds are allocated by the financial institutions to other sectors of agriculture, such as, livestock, poultry farming, fish farming, horticulture, and live stock in comparison to local farming. All these sectors by their nature require a great amount of money and are hence, not ventured into a small farmer for whom agriculture is a source of life

and not business.[713] The special treatment given by the financial institution to these sectors is due to many reasons. For example investment in such sectors looks protected as the owners are financially strong and can repay the loan easily. Similarly, they have the mandatory collaterals and securities required for the release of loan. The following statement, given in the guideline for Islamic agricultural finance, indirectly shows the inner intention of the State Bank.

> "Individuals/ partnership concerns and all types of legal entities engaged in agriculture related activities, having sufficient knowledge and relevant experience are eligible to get financing under the Islamic financing scheme".[714]

This really defeats the basic purposes of agricultural finance and consequently the intended results are not achieved. According to another guideline, known as Financing Scheme for Small Farmers, issued by the central bank, a farmer must fulfill the following two conditions.[715]

1. Individual should be a holder, tenant, and lessee or allotted farmer of land up to 12.5 acres.

2. Individual have sufficient knowledge of the business/ activity being carried

Both these conditions are very much difficult to be fulfilled by majority of farmers of the country owing to the fact that they have ownership of very small pieces of land; almost less than 12 acres. The second condition is left to the discretionary power of the financial institutions,

---

[713]According to a report related to the feasibility of poultry Breeder farm, issued by the Small and Medium Enterprise Development Authority (Government of Pakistan), the minimum cost(capital cost and working capital) required for the commencement of such project is RS.23, 97,292. This huge amount can not be provided by a small farmer or even by a farmer who belongs to lower middle class………………….. Pre-Feasibility Study, poultry Breeder farm, Small and Medium Enterprise Development Authority Government of Pakistan, http://www.amis.pk/pdf/.../SMEDA%20%20Poultry%20Breeder%20Farm.pdf(accessed: 28th February , 2014).

[714]*Guidelines on Islamic Finance for Agriculture*, the Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, pp.13,14.

[715]*Financing Scheme for Small Farmers*, Agricultural Credit Department, Islamic Banking Department, State Bank of Pakistan(accessed: 28th February , 2014),p.4.

which do not have inclination to finance lower sector of the society. The Guideline on Islamic Agriculture Finance almost put the same conditions for borrowers.[716]

The eligibility criterion mentioned in these guidelines is not based on solid grounds from *Sharī'ah*'s perspective. Islamic commercial law does not recognize the strict eligibility criteria for a borrower, rather it emphasis the believers to help out others at the time of dire need. In this regard the Holy *Qur'ān* says

> "*Ye loan to Allah, a beautiful loan, He will double it to your (credit), and He will grant you Forgiveness: for Allah is most Ready to appreciate (service), Most Forbearing"*[717]

In another verse the same directions are given

> "Establish regular Prayer and give regular Charity; and loan to Allah a beautiful loan [QH] And whatever good ye send forth for your souls ye shall find it in Allah's Presence, - yea, better and greater, in Reward and seek ye the Grace of Allah, for Allah is Oft-Forgiving, Most Merciful*"*[718]

The same directions are given to the believers by the *Sunnah* i.e. *"*anyone who gives *Qard-al-Hassan* two times, is just like he advances *Sadaqha* one time"

Although the above mentioned verses of the Holy *Qur'ān* and *Sunnah* are purely related to the concept of *Al Qard ul Hasan* and not to other modes of Islamic finance like *Murābahah, Musāwamah, Salam , Istisnā', Mushārakah, Diminishing Mushārakah, Musāqah*, *Muzāra'* and *Ijārah*. However, being a financing mode, the basic philosophy of *Al Qard ul Hasan* (which is to help out poor segments of the society) can also be extended through analogy to other modes of Islamic finance. In addition, all modes of Islamic finance are structured in such a way to help out a less fortunate person (in terms of wealth). For instance, *Mudārabah* is a famous mode of Islamic finance where wealth flows from the hand of a rich into that of poor. On the same way

---

[716] *Guidelines on Islamic Finance for Agriculture*, the Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, pp.13,14 .

[717] *Qur'ān* 17:64.

[718] *Qur'ān20:73.*

the contract of *Salam* is recognized in order to help out poor farmers in buying basic agricultural needs. Mufti Muhammad Taqi Usmani has the same view when he says

> Salam was allowed by the Holy Prophet (SAW) subject to certain conditions. The basic purpose of this sale was to meet the needs of the small farmers who needed money to grow their crops and to feed their family up to the time of harvest. After the prohibition of *Ribā* they could not take usurious loans. Therefore, it was allowed for them to sell the agricultural products in advance. …..[719]

Mushārakah also has the same philosophy where two or more individuals combine their little investments in order to accumulate a huge amount and then invest the same in some profitable business. These individuals do not have sufficient amount in their individual capacity to start some business, and therefore, they conclude the contract of *Mushārakah*.

The above discussion shows that the policy of strict eligibility criteria, settled by the financial institutions, is agains the basic philosophies of Islamic financial system. Such philosophies must be transalated into practical utility by the Islamic financial institutions and should ensure assistance of poor farmers in fulfilling their agricultural requirements. It is advised, therefore, that the eligilbilty and creditworthiness criteria should be relaxed to a great extent so that poor farmers may get more benefit from all financing schemes offered by the Islamic financial institutions. For instance, it should not be made mandatory that a farmer who applies for financing facility should be a holder, tenant, lessee or allotte farmer of land up to 12.5 acres. The reason is that majority of farmers in Pakistan are having less than 12 acres, and therefore, they usually cannot meet the eligibility criteria. Some of the scholars noticed the same issue and rightly stated

[719]Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.186.

> "In Pakistan 88% of the total farming population has less than five hectare of land. They are living from hand to mouth. Moreover, majority of these farmers do not have collateral and thus are deprived of the loan facilities".[720]

Therefore, the credit worthiness would be measured by some other means, like his social character and social relations, rather than the size of a land. Similarly, the State Bank of Pakistan should not leave the credit worthiness criteria to be determined by the Islamic banks and other Islamic financial institutions rather it should do the same by itself. The established criteria would be then imposed on the financial institutions.

6.2.4 The Issues in Collateral and Securities

Collaterals and securities are the most important requirements of financial institutions for the provision of financing facility. The credit worthiness of a client is determined on the basis of securities that he can provide. The financial institutions use securities as a risk minimization tool in order to decrease the number of defaulters. The State Bank of Pakistan, while realizing the importance of collateral, has advised the Islamic financial institution to secure their financing and investment by accepting security and collateral as per their financing policies which may include the following.[721]

1. Charge on agricultural land through passbook system.
2. Mortgage of commercial rural, urban or commercial property.
3. Mortgage of asset.
4. Lien on IBI deposit, IBI guarantee
5. Individual or group guarantee
6. Any other tangible collateral security acceptable to IBI

The pre requirements for the provision of loan act as a hurdle in securing agricultural finance as majority of farmers in the country are not in position to provide the required securities, and therefore, avoid getting the financing facilities. In case of rural farmers the situation becomes

---

[720] Urooba Pervaiz, Dawood Jan, Muhammad Zafarullah Khan, Mahmood Iqbal,Rukhsana Javed, *Disbursement of Agricultural Loans, Constraints and its Future Policy Implication*, Sarhad J. Agric.vol.27, no.2.

[721] *Guidelines on Islamic Finance for Agriculture,* the Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.13.

worse where majority of farmers do not have their own land. The report of Agricultural Census2000 shows that only 37 percent farmers of the rural areas have their own land while 61 percent of these land-owning households owned fewer than five acres, or 15 percent of total land.[722] While recognizing this fact, the State Bank of Pakistan has taken some initiatives and allows the financial institutions to provide unsecured loan to the extent of Rs.1.0 million.

> "Banks/DFIs shall not provide unsecured/clean financing facility in any form of a sum exceeding Rs 1.0 million (Rupees one million only) to any one person. Financing facilities granted without securities including those granted against personal guarantees shall be deemed as "clean" for the purpose of this regulation."[723]

On the same way group based lending mechanism is recognized by the central bank in order to cope with the issue of collateral and securities.

> "(The State Bank of Pakistan has) Issued Financing Scheme for Small Farmers on group based lending methodology whereby members of the group can borrow up to Rs 200,000/- without any collateral from financial institutions"[724]

However, in a guideline issued by the State Bank of Pakistan for Islamic agricultural finance, none of such regulations are mentioned, and therefore none of the Islamic financial institution provides financing without appropriate collaterals. The conventional financial institutions too follow the same way instead of proper directions from the regulatory authority.

There are many issues in the existing structure of collateral and securities mentioned by the State Bank of Pakistan in the guideline for Islamic agricultural finance. According to an established principle of Islamic commercial law, guarantee in trust contracts is not permitted.[725]According to the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), a contract of guarantee is permissible in contracts of exchange e.g. contract

---

[722]Mazhar Arif, *Agriculture And Food Security in Pakistan*, Thematic Paper,p.13

[723]*Prudential Regulations for Agriculture Financing*, Agricultural Credit & Microfinance Department State Bank of Pakistan, updated on 29thJanuary, 2014, Regulation no.4, p.8 http://www.sbp.org.pk/publications/prudential/PRsAgriApproved.pdf, (accessed: 28th October , 2014).

[724]*Handbook on Best Practices in Agri/Rural Finance*, Agricultural Credit Department, State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

[725] Ibn Qudāmah al-Maqdisī, *Al-Kafī*, Kitāb-al-Zamān, p.230.

of sale or contract of rights, e.g. right of intellectual property.[726] It is not permissible to stipulate any guarantee in trust contracts like agency contract, contract of deposits, and therefore, no guarantee can be taken in the contract of *Mushārakah* or *Mudārabah*.[727] Some of the scholars even do not allow guarantee in *Salam* contract.[728] However, the guideline on Islamic agricultural finance does not differentiate between the contracts of exchange and the contracts of trust as for as the application of guarantee is concerned. Similarly, *Sharī'ah*' have more inclinations towards the personal guarantee owing to the fact that it is more reliable and easier as compared to other types of guarantees like mortgage, pledge, etc This fact can be established from the Holy *Qur'ān* and *Sunnah*. According to the Holy *Qur'ān* "They said: we miss the great beaker of the king; for him who produces it, is (the reward) a camel load; I will be bound by it"[729] In *Sunnah,* a hadith is narrated by Salamah Bin Al Akwa, who said: we were with the Prophet (SM) when a deceased person was brought. They said," O Prophet, perform prayers on it," He said, "Has the deceased left anything? They said: No, He said "Is he in debt", they said:"Three dinars". He said" perform prayers on your companion" Abu Qatadah said: "O messenger of Allah, perform prayer on him, and I am responsible for his debt" then the Prophet performed prayers on him.[730] While as for as the guidelines for agricultural finance is concerned, they give more value to other type of securities rather than personal guarantees. Therefore, the guideline on Islamic agricultural finance starts the list of securities from charge on agricultural land through passbook system, mortgage of commercial rural, urban or commercial property, mortgage of asset, lien on IBI deposit, IBI guarantee and comes to an end at individual or group guarantee. This shows that priority is always given to pledge and mortgage rather than personal guarantees. The guideline also recommends individual and group based guarantee and *Sharī'ah*' too recognizes the same. However, empirical research shows that farmers always prefer individual guarantee and considers it difficult to find more than one individual as guarantors for securing loan. So, the

---

[726]*Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI),* Sharī'ahStandard No.5,Rule No. 2/1/2, English Version, p.57.
[727]Ibid, Rule No.2/2/1,p.57.
[728] Ibn Qudāmah al-Maqdisī, *Al-Kafī*, Kitāb-al-Zamān, p.230.
[729]*Qur'ān72:12.*
[730]*Guidelines on Islamic Finance for Agriculture,* the Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.13.

group based guarantee is against the basic philosophy of *Sharī'ah* i.e. *Tayseer* (easiness). Some measures must be taken by the State Bank of Pakistan for the solution of high collaterals and securities issue in order to facilitate and encourage farmers to go for securing the financing facilities. It is advised, for example, that the central bank should ask the Islamic financial institutions to opt an individual guarantee rather than group based in financing agriculture, particularly local farming. The provision of this individual guarantee would be easier for a farmer than the provision of the group based securities. On similar way, pledge of ornaments, gold and other precious things should be accepted as a guarantee owing to the fact that all such type of securities can be easily provided by farmers. In some cases where the credit worthiness of a farmer can be ensured in some other ways, then requirement for furnishing securities should be avoided to the possible extent.

6.2.5 The Issue of Agency in Agricultural Financing

According to the guideline on Islamic agricultural finance, issued by the State Bank of Pakistan, the Islamic financial institutions may not have the required experience to purchase the required agricultural commodities from the local market due to the lack of trading experience, limited knowledge, wide range exposures, diversified demands, customer specific needs etc. In such a situation, it is permissible for the Islamic financial institutions to hire the services of an individual as an agent for purchasing the required commodity from the open market. The institutions are also allowed to appoint the customers as their agents, in case of dire needs, for the same task. In this later case, being a principal, all risks will be borne by the Islamic bank.[731]

The customer agency recommended by the guideline for Islamic financial institutions, is repugnant to the injunctions of *Sharī'ah*' from many aspects. In many cases a financial institution appoints its customer as an agent, while third party agencyship is almost ignored. This is not only a violation of the guideline issued by the central bank but also breaches the rules and regulations mentioned in the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI). It states that,

[731] Ibid, p.2 .

> The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for it to carry out the purchase by authorizing an agent, other than the purchase order, to make the purchase, and the customer should not be appointed to act as an agent except in a situation of dire need. Furthermore the agent must not sell the item to himself; rather, the institution must first acquire the title of the item and then sell it to the agent"[732]

The above statement shows that customer's agency is not prohibited, but is not a preferred option. Making use of that provision, the Islamic banks and other Islamic financial institutions can appoint a farmer as their agent but with the condition that they pay the price of the commodity to the supplier directly and obtain documents confirming sale transaction. This arrangement will be mutually beneficial both for the Islamic bank and the farmer. The Islamic bank in this way will acquire the right commodity without its own active participation, and hence would save time and cost. The farmer on the other hand will receive charges for his agency from the Islamic bank which will automatically reduce the price of the commodity for him. Moreover, he will acquire the commodity as per his/her choice.

Keeping in mind the discouragement and non-prohibition of customer's agency, another view can be presented in the shape of the following suggestion. The Islamic banks and other Islamic financial institutions can appoint a farmer, other than the farmer who applied for securing financing facility, to purchase the commodity. This farmer based on his agricultural experience will be able to identify the asset and negotiate an efficient price on behalf of the Islamic bank. It can appoint such a person for a series of transactions. The appointment of such farmer, other than the customer, is the ideal solution in the sense that the bank will not have to buy the commodity itself, and will also avoid customer's agency, which is not advisable from *Sharī'ah* perspective. This would be the ideal solution of the issue in the existing circumstances.

Another issue in the agency structure given in the guideline is related to the remuneration of a farmer when he provides his services as an agent of the bank. According to the renowned contemporary Jurist Wahbha -al-Zuhaylī, "It is permissible for an agent to take charges from his

---

[732]*Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI),* Sharī'ahStandard No.8,Rule No. 3/1/23, English Version, p.117.

principal and he can also do the same (agency) without any consideration[733]. Therefore, the silence of the guideline related to the compensation of the farmer for his agency is violation of the basic principle of Islamic commercial law. The *Sharī ʻah* Standards (AAOIFI) do not even talk about this concept. It is therefore advised that the central bank should include provision related to the consideration of farmer as an agent.

6.2.6 Violation of *Maqāsid -al- Sharī`ah* (objectives of Islamic law)

The guideline on Islamic agricultural finance, issued by the central bank, violates *Maqāsid -al- Sharī`ah* from many aspects. Firstly, it is designed in such a way that it promotes and serves more interest of the rich class of farmers rather than that of lower class. For instance, more emphasis is given to poultry farming, fish farming, horticulture, and live stock in comparison to local farming. All these sectors by their nature require a great amount of money and are therefore, not ventured into a small farmer for whom agriculture is a source of life and not business.[734]This clearly shows that even the central bank does not look after the interest of lower class of farmers who are deserved more to be financially assisted. Concentration on the interest of rich class of farmers goes against the basic objectives of *Sharī`ah* envisaged by contemporary scholars i.e. social welfare and support.[735] Secondly, local farming is a source of basic food for the human beings. It is a source of wheat, paddy, sugarcane, cotton, potato, mustard, tobacco, rape seed, maize (hybrid), maize (local), mash, canola, lentil, soybean, groundnut, sunflower, pears, dates, strawberry, plum, tea, apple, pomegranate, almond, palm, coconut, olive oil, leechi, walnut, cherry, apricot, melon, banana, water melon, peach, mush melon, citrus etc. It is therefore, need of the time to give priority to local farming over other

---

[733] Wahbah-al-Zuhaylī, *Al-Fiqh-al-Islāmī –Wa-Adilatuhū*, vol.5,p. 4058.

[734]According to a report related to the feasibility of poultry Breeder farm, issued by the Small and Medium Enterprise Development Authority (Government of Pakistan), the minimum cost(capital cost and working capital) required for the commencement of such project is RS.23, 97,292. This huge amount can not be provided by a small farmer or even by a farmer who belongs to lower middle class………………….. Pre-Feasibility Study, poultry Breeder farm, Small and Medium Enterprise Development Authority Government of Pakistan, http://www.amis.pk/pdf/.../SMEDA%20%20Poultry%20Breeder%20Farm.pdf(accessed: 28th February , 2014).

[735]Yūsuf al-Qardāwi adds social welfare, and support, freedom, human dignity, and human fraternity to the classical list of Maqāsid-al- *Sharī`ah*………Mohammad Hashim Kamali,*Maqasid al Shariah: The Objectives of Islamic Law*, http://www.sunniforum.com/forum/showthread.php?6176-Maqasid-al-Shariah-The-Objectives-of-Islamic-Law(accessed: 25th August, 2014).

sectors of agriculture on the same way as *Dhurariyyat* (necessities) are given priority over *Hajeyyāt* (needs) and *Tehsiniyāt*(luxuries). However, the guideline on Islamic agricultural finance is structured against this basic approach of Islamic law towards human needs and wants. Thirdly, the rules, regulations and requirements related to eligibility criteria, guarantee, recovery, procedure etc are designed in such a way that create difficulty for lower class of farmers, and consequently, they avoid to get financing facility. This goes against the basic philosophy of *Maqasid-al- Sharī`ah* i.e. *Tayseer* (easiness).

The solution to the above issue is not so simple and it requires drastic changes in the existing mechanism and structure of Islamic finance in order to make it in compliance with *Maqasid-al- Sharī`ah*. The role of *Sharī`ah* advisors is very important in this regard. They have to check each and every commercial transaction of Islamic banks and other Islamic financial institutions from the perspective of objectives of Islamic law, particularly those objectives which are envisaged by Islam for commercial transaction. On similarly way it is the responsibility of the State Bank of Pakistan, being a regulatory authority, to issue a comprehensive guideline, asking the financial institutions to show firm adherence to the same in their financing schemes and policies. Such guideline should be prepared under the guidance of its learned Sharī*`ah* Advisory Board. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) can also play a vital role in this regard by asking the well renowned contemporary Muslim Scholars for the formulation of new standards on the basis of objectives of Sharī*`ah*.

6.2.7 No Assurance for Active Involvement of IFIs in Agribusiness

According to Islamic commercial law money has no intrinsic value, and hence, cannot be used as a source of profit. In commercial activities, like, purchase and hiring, currency can be used only as a medium of exchange. Commodity on the other hand can be used as a source of profit for having intrinsic value and capability for value addition. While following this basic philosophy, money cannot become a subject matter of trade in any form. Conventional financial system allows both money and commodity as sources of profit, and therefore, no legal restriction is put on trading in currencies. Here the difference between conventional and Islamic financial institutions becomes clear in terms of their operations. Islamic banks and other Islamic financial

institutions are bound to be involved in actual business activities and should not provide financing on interest basis.

The guideline on Islamic agricultural finance, issued by the State Bank of Pakistan, has ignored the above principle and does not ask the financial institutions to actively participate with farmers in agribusiness. The term 'financing agriculture' is frequently used in the guideline which is a solid evidence of the fact that active involvement in trade is not declared mandatory. The guideline itself states" There are certain issues and problems in implementing the trade model of Islamic finance in Islamic banking industry, which can be addressed through adherence to the rules of Islamic financing………"[736] It further adds, that Islamic financial institutions should do physical inspection of the required agricultural goods and commodities and should also take their possession, either actually or constructively. However, the guideline then provides exceptions to this principle and allows the Islamic banks to go for customer agency, indirect inspection of the property, indirect payment through agent. All these are various subterfuges recommended by the central bank in order to keep away the financial institution from actual trade in agribusiness. The various concepts like securities, collateral, insurance, monitoring, recovery system etc, show that the central bank does not look for true Islamic agricultural finance rather it compels the Islamic banks to design their agricultural finance on the line similar to that of conventional agricultural finance .

It is, therefore, advised that the central bank should bind, particularly, the Islamic financial institutions to actively participate in the business rather than playing the role of a mediator only. However, such sort of active involvement requires some relaxation in regulatory issues. For instance, the State Bank of Pakistan should work for legislation in this regard. The Islamic banks and other Islamic financial institutions should be allowed to have their own property and premises. By this way, it would be possible for them to have their own show room of cars from where they would sell and rent out cars on *Murābahah* and *Ijārah* respectively. They would also be in a position to have their own building where they would collect and store *Salam* commodities. In short, these financial institution would be then in a potion to actively participate

[736] *Guidelines on Islamic Agricultural Finance*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.2.

in the business. The Muslim scholars, particularly those who are directly related to banking industry in various capacities, should present strong theoretical background of Islamic finance, where banks are urged to ensure their active participation in various business activities.

6.2.8 No Inclusion of *Muzār'ah, Musāqah* or *Mu'āmalaha* and *Mughārasa*

There are some special contracts in Islamic commercial law, designed for agricultural development and production. These contracts include *Muzār'ah, Musāqah* or *Mu'āmalaha* and *Mughārasa*. *Muzār'ah* is a contract for cultivation of land in return for part of the produce in accordance with the conditions stipulated by law.[737] According to Ibn Qudamah "it is a contract where a land is handed over by one party to another for cultivation in return for part of the produce".[738]*Musāqah* or *Mu'āmalaha*, another important agricultural contract, is defined by Imām Kāsānī as "a contract of work for part of the produce along with the condition of validity".[739] A more comprehensive definition is given by Ibni Qudamah, "It is a contract for the caring of trees for part of their fruits".[740] *Mughārasa* is a contract where one party provides a treeless piece of land to another to plant trees on it on the condition that they share the trees and fruits according to the agreed ratio.[741]

The guideline on Islamic agricultural finance has ignored the above mentioned specialized agricultural contracts. Although the guideline discusses the basic principles, application and procedure for all these transactions with minute details; however, they are discussed neither in term financing nor in working capital. This ignorance is ironical in nature as all these transactions have a great potential for the enhancement of agricultural production, both in crop and non crop activities. For example, *Muzār'ah* is very useful especially for large lands where two banks are interested in participating in the agricultural finance.[742] Similarly, *Musāqah* or *Mu'āmalaha* is a very useful transaction especially in the rural areas. Such an arrangement will reduce the menace of unemployment in these localities to a great extant. For example if there is a

---

[737]Marghinānī ,*Al Hidāyah Sharh Bidāyat ul Mubtadī*, vol.7,p.99.
[738]Ibn Qudāmah al-Maqdisī, *Al-Kafī*, vol.2, p.298.
[739]Kāsānī, *Bādā'i' al-Sanā'i'*, vol.6,p.280.
[740]Ibn Qudāmah al-Maqdisī, *Al-Kafī*,vol.2, p.289.
[741]*Guidelines on Islamic Agricultural Finance*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.12.
[742] Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transactions*, p.70.

Musāqah contract between the Islamic bank and owner of the land then the former will provide labour and will be responsible for the entire work on the land while the latter will provide land having fruit trees.[743] In this scenario it is possible for the Islamic bank to hire the services of other local farmers who will irrigate the trees and carry out other work related to their responsibilities. However, the central bank does not take concrete measures for implementing all these transaction in agricultural financing schemes. The reason is that all these contracts necessitate active involvement of the parties which is against the basic nature of the business techniques used by the financial institutions. Because of this reason none of the financial institution in the country has applied these contracts yet.

The above issue can be solved on the same way as the previous one. The State Bank of Pakistan should ask the Islamic banks and other Islamic financial institutions to apply *Muzār'ah, Musāqah* for financing agriculture. The financial institutions can hire the services of farmers of a particular locality on *Ijārat-ul-Ashkhās* (hiring of personal services) and then conclude *Muzār'ah, Musāqah* with another farmer, having a large piece of land i.e. a land lord. By this way, both these typical transactions can be applied for the benefit of lower, middle and upper class of farmers. Being typically structured for agriculture, the viability of both these transactions is beyond any doubt for the development of agricultural sector, both for crop and non crop activities. However, some basic changes must be brought in the existing structure of banking structure in Pakistan in this connection.

6.2.9 Use of Conventional Insurance for Loan Disbursed

The major issue in the contemporary Islamic agricultural finance is the insurance coverage used by the financial institutions to protect the amount disbursed for crop and non crop activities. In addition to the amount financed, the life insurance of the borrower will also be arranged in order to safeguard rights of both bank and its borrower.[744] Sometime insurance policy is extended to agricultural yield for the purpose to protect the concerned parties from bearing loss in case of

[743]Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, *Mushārakah—A Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Arab Law Quarterly, vo.28, Issue 1, 2014,pp.: 1–39 (39).

[744]*Financing Scheme for Small Farmers*, Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.6 (accessed: 28th February, 2014).

natural disaster like droughts, floods, hail storms, earthquakes, mudslides, and a multitude of other mishaps.

Being prohibited commercial deal in *Sharī`ah*, the Islamic financial institutions are not allowed to opt any type of insurance in their financing activities. However, as an alternate, the concept of *Takāful* (Islamic insurance) can be used to serve all the required purposes. The guideline on Islamic agricultural finance, issued by the central bank, ironically advises the Islamic financial institutions to cover their advanced amount through insurance. The word 'insurance' is more frequently used with the word '*Takāful*', allowing the financial institutions ,indirectly, for securing their financing through conventional insurance. The following statement of the guideline can be cited as evidence in this regard

> "IBIs can secure their financing by obtaining documents as per their financing policies and SBP regulations and guidelines……..Completion of documentation formalities shall be the responsibility of IBI. Further insurance/ Takaful cover should be obtained for the asset to safeguard the interest of IBI and the customer from risks of losses due to circumstances beyond the control of the customer. It is advisable that IBIs should sensitize and educate their customer about the importance of having an insurance /Takaful cover in this regard"[745]

Even the same words are used in another guideline issued by the central bank for conventional agricultural finance

> "Banks are advised to arrange insurance of the amount of loan disbursed for crop and non crop activities and life insurance of the borrower to safeguard the interest of the borrower and the bank, in cases of losses due to natural calamity or event beyond the control of the borrower"[746]

---

[745]*Guidelines on Islamic Agricultural Finance,* Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.13.

[746]*Financing Scheme for Small Farmers,* Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, p.6 (accessed: 28th February, 2014).

Like the previous problems, this one can also be sloved through the active involvement of the central bank. Being a regulatory body, the central bank is supposed to bound the Islamic financial institutions to follow *Takāful* in Islamic agricultural finance. Some strict actions should be taken against the financial institutions that do violation of the regulations and use conventional insurance. However, the statement clearly indicates that even the central bank does not go actively for the implementation of true Islamic agricultural finance in the country.

Summary, Conclusion and Recommendations

In Pakistan there are two kinds of formal financial institutions. The first kind includes those financial institutions, which work purely on the basis of interest, known as conventional financial institutions, while the second category consists of those financial institutions which are working according to the principles of Islamic commercial law, and have their own rules and regulations. Both types of financial institutions are financing agriculture for crop and non crop activities.

In Pakistan, the formation of Agricultural Bank and Agricultural Development Finance Corporations (ADFC) in 1950's could be considered the first major step for the Development of agriculture sectors. The purpose behind both these financial institutions was to overcome the credit shortage prevailing at that time. Later on in the 1960's both institutions were merged and a specialized agricultural bank was formed i.e. the Agricultural Development Bank of Pakistan (ADBP). This bank later named Zarai Tariqiati Bank Limited (ZTBL). It was a leading conventional financial institution working for the development of the agricultural sector both in crop and non-crop activities through the provision of financial services. Its job was also to provide technical assistance to the agricultural sector by various ways. The critical purpose of the institution was to augment the agriculture and rural sector by lifting up farm production, reforming the institutional credit and increasing income generating capacity of the farming community. Later on ZTBL was incorporated as a Public Limited Company on 14th December, 2002 through repeal of ADB Ordinance of 1961. However, the

bank did not play the role which was intended at the time of its inception. The State Bank of Pakistan had recognized the fact that ZTBL could not cover the agricultural sector's requirements efficiently. It issued various mandatory regulatory frameworks, compelling the commercial financial institutions to allocate certain portions of their credit portfolio for the development of the agriculture sector. The commercial banks while following instructions of the central bank had started financing agriculture both for crop and non-crop activities. These banks included existing commercial banks of the country, such as, Allied Bank Limited (ABL), Habib Bank Limited (HBL), United Bank limited (UBL), National Bank Limited (NBP), and Muslim Commercial Bank (MCB). These commercial banks, however failed badly to fulfill the required objectives demanded by the State Bank of Pakistan (SBP). There were many reasons for the failure of these financial institutions. Firstly, agricultural sector had some potential risks including both natural calamities (like droughts, floods, hail storms, earthquakes, mudslides and a multitude of other mishaps) and artificial catastrophes, like, price risks both for inputs and crops, political risks, risks related to poor support infrastructure), and Investment in such a sector would mean facing potential risks which was not a desirable option. Therefore, the financial institutions used to avoid the allocation of required liquidity for financing agriculture. Secondly, the commercial banks were asked by the State Bank of Pakistan to advance loans to the agricultural sector and its various sub-sectors without demanding collaterals from farmers. In some cases they were asked to provide loan facility by requiring only personal sureties. This sort of arrangement was against the basic business nature of financial institutions where they required securities to secure their investments. Thirdly, the financial institutions of the country (like the specialized bank for financing agriculture i.e. Agricultural Development Bank, commercial banks, Cooperative Banks) did not distribute the credit on the basis of justice. The upper class of farmers (landlords) were provided a major portion of agricultural credit while the middle and lower class of farmers that deserved more to be financially assisted, had deprived. The subsidized agricultural credit was also provided to the upper class of farmers for being more politically influential and financially stable to provide the collaterals, required by these financial institutions for the provision of loan facility. Therefore, the local farming, being a sector of poor and lower middle class of farmers, was badly ignored. Fourthly, the staff of financial

institutions had no agricultural academic back ground and had no experience as far as the agricultural sector was concerned. This led to a situation where such institutions badly failed to mobilize deposits and made loan portfolio of good quality. For example, such financial institutions were not in a position to make the recovery rate better, minimize the transactional costs, and reduce the political influence in disbursing loans. This problem was noticed by the State Bank of Pakistan and therefore, issued guidelines on various financing schemes particularly those which were related to agricultural financing in order to create awareness among the bank officers regarding agriculture finance. Fifthly, the financial institutions had concentrated more on urban areas as compared to rural areas of the country due to their remoteness and political instability, and therefore, opening branches in such areas for financing agriculture was like a commercial suicide. Sixthly, the very few financial institutions that were involved in rural agricultural finance did not take necessary steps in order to minimize the inherited risk of agricultural financing. The insurance facility which was normally available in urban agricultural credit had not extended to rural agriculture finance. The lack of proper measures for risk minimization turned the agriculture less viable for conventional financial institutions. Seventhly, the commercial banks in rural areas had charged high interest rates from the farmers and exploited their compelling situation to a great extent. Being a major contributor in the county’s food requirements, it was supposed that financial institutions would provide loan to rural farmers on the easiest terms and conditions. However, these financial institutions had showed a completely different approach and provided loan at high interest rates to the agriculture sector both in crop and non-crop activities. For instance the rate of interest was between 10 to 20 percent, and surprisingly it was 17 percent in Barani Punjab followed by 17 percent in Baluchistan. According to researchers, the State Bank of Pakistan was itself responsible for such exploitative rates of interest as it had given a free license to all financial institutions to charge any rate of interest. Eighthly, another major defect in formal finance was the demand of high collaterals for the advancement of loan. This prerequisite acted as a main hurdle for farmers to secure loans from commercial banks and other financial institutions. They were not in a position to furnish such securities, and consequently left their intention to get the loan facility. This approach was intentionally done, keeping away the lower class of farmers from securing financial facility.

As a result, only the middle and upper class of farmers received a sizable portion in agricultural loan as they were in good position to furnish such securities.

Besides the defects mentioned above in the basic structure of agriculture credit, there are some legal issues that cause failure of such credit system. Firstly, the financial institutions in Pakistan follow a specific procedure for the advancement of loan facility. Such procedure is usually very rigid, comprises of many steps, and takes excessive time for its completion. In case of agricultural loans, procedures become more rigid because of the inherited risks involved in this sector. Secondly, In case of intentional default on the side of a farmer, there is no proper legal system and mechanism to protect effectively the commercial banks and other financial institutions. The general procedure of law for the recovery of loan if followed, the amount on litigation sometime crosses the amount due. Thirdly, the existing documentation's techniques followed by the financial institutions, for the provision of agricultural credit, are objectionable from many aspects. For example illiterate farmers are they are not in position to understand the complex type of documentation required by the financial institutions for the advancement of loan. Fourthly, in Pakistan there is no clear property right particularly in rural parts of the country which is a hub for agricultural activities. Due to the lack of proper legal mechanism of ownership, the banks are not clear about the legal capacity of a farmer based on which he holds the mortgaged property. It is usually very much unclear whether a farmer owns the property or just he controls or benefits from the same and consequently the use of land as collateral is discouraged.

*Sharī'a*h restrains Muslims from securing any loan, whether from formal or informal sources, based on interest. To be *Sharī'a*h compliant, Muslim farmers, are forced to fulfill their agricultural needs from other sources of financing acceptable and endorsed by Islamic financial system. Being a complete code of life, Islam presents a comprehensive and easy way for farmers, Islamic banks and Islamic financial institutions to enter into various commercial transactions which are viable for stake holders; and also indispensable for the development of agricultural sector both for crop and non -crop activities. These transactions can be divided into trade based modes, such as, like *Murābahah, Musāwamah, Salam, and Istisnā'* ;participatory modes, such as, *Mushārakah, Diminishing Mushārakah, Musāqah, and Muzāra'h* ; rent based modes, such as *Ijārah* which can be further divided into *Ijārat*-ul-*Ashkhās and Ijārat*-ul-*Asyā*. All these

transactions have a potential to help a farmer to fulfill his agricultural needs that start from basic agricultural inputs like seeds, fertilizers, herbicides, weedicides, and basic agricultural tools and ends with heavy agricultural machinery like tractors, thrashers,and harvesters. These can also be used effectively for the development of other sectors of agriculture like livestock, fish farming, dairy farming, poultry farming, and horticulture. However, the intended results from all these modes of Islamic finance option can be achieved with a condition if some alterations (in the light of survey conducted) are made in the existing structure employed by the Islamic banks and other Islamic financial institutions. These changes include minimization of securities or its removal at all, reduction of un-required documentation, making of new approaches and alternatives to customer agency, active involvement of the financial institutions, maximization of duration for installments, flexibility in terms of repayment particularly in case of natural disaster and mishaps, charging of less profit from the farmers as compared to ordinary customers etc. The Islamic banks and other Islamic financial has started financing agriculture on the basis of Islamic modes of financing. However, the intended results are not achieved and like the conventional financial institutions they too have faced failure. There are many reasons for this failure. Firstly, being a regulatory body the State Bank of Pakistan has asked all the financial institutions to determine their mark up on the basis of KIBOR, a bench mark that is used by the conventional financial institutions for the determination of interest rates. The word “financial institutions’ includes Islamic banks and other Islamic financial institutions, and therefore, they also determine their profit margin according to the same bench mark. Secondly, in the guideline, issued for Islamic agricultural finance, the State Bank of Pakistan has recommended very rigorous rules and regulations for monitoring and recovery system. This procedure is not in line with the rules and regulations described by *Sharīʻah* for the recovery of any financial liability. Islamic commercial law presents a recovery procedure which is based on the principle of justice, easiness and human respect. Therefore, it advises creditor to give relaxation to the debtor till a time when the debtor is in a position to make payment. If the debtor is unable to repay the amount at the given time, in special cases, it is advised that the amount may be remitted as a charity. Thirdly, a closer scrutiny shows that such eligibility standards are settled in such a way that a lower class and lower middle class of farmers cannot fulfill it, and therefore, the financing facilities are provided to upper middle class and upper class of farmers. On the same way some

time the financing activities are shifted to corporate clients and individual farmers are ignored. The eligibility criterion is not based on solid grounds from *Sharī'ah*'s perspective. Islamic commercial law does not recognize the strict eligibility criteria for a borrower, rather it emphasis the believers to help out others at the time of dire need. Fourthly, the guideline on Islamic agricultural finance starts the list of securities from charge on agricultural land through passbook system, mortgage of commercial rural, urban or commercial property, mortgage of asset, lien on IBI deposit, IBI guarantee and comes to an end at individual or group guarantee. This shows that priority is always given to pledge and mortgage rather than personal guarantees. *Sharī'ah*', on the other hand, have more inclinations towards the personal guarantee owing to the fact that it is more reliable and easier as compared to other types of guarantees like mortgage, pledge, etc. Fifthly, the customer agency recommended by the guideline for Islamic financial institutions, is repugnant to the injunctions of *Sharī'ah*' from many aspects. In many cases a financial institution appoints its customer as an agent, while third party agencyship is almost ignored. This is not only a violation of the guideline issued by the central bank but also breaches the rules and regulations mentioned in the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI). Sixthly, the guideline on Islamic agricultural finance, issued by the central bank, violates *Maqāsid -al- Sharī`ah* from many aspects. Firstly, it is designed in such a way that it promotes and serves more interest of the rich class of farmers rather than that of lower class. For instance, more emphasis is given to poultry farming, fish farming, horticulture, and live stock in comparison to local farming. All these sectors by their nature require a great amount of money and are therefore, not ventured into a small farmer for whom agriculture is a source of life and not business. Secondly, local farming is a source of basic food for the human beings like rice, wheat, paddy, sugarcane, cotton etc, and therefore, priority must be given to local farming over other sectors of agriculture on the same way as *Dharuriyyat* (necessities) are given priority over *Hajeyyāt* (needs) and *Tehsiniyāt* (luxuries). However, the guideline on Islamic agricultural finance is structured against this basic approach of Islamic law towards human needs and wants. Seventhly, the guideline on Islamic agricultural finance, issued by the State Bank of Pakistan, does not ask the financial institutions to actively participate with farmers in agribusiness. The term 'financing agriculture' is frequently used in the guideline which is a

solid evidence of the fact that active involvement in trade is not declared mandatory. Islamic commercial law, on the other hand, requires active involvement of all partners in the business.

The intended results from all modes of Islamic finance option can be achieved with a condition if some alterations (in the light of survey conducted) are made in the existing structure employed by the Islamic banks and other Islamic financial institutions. Firstly, the existing procedure described by *Sharī ʻah* Standards (AAOIFI) is very complex in nature and should be replaced with a simple procedure understandable by the farmers who desperately need the financing but may find it difficult to understand the complicated process currently in place. Secondly, these institutions need to earn less profit from farmers as compared to other general customers in concert with the basic philosophies of cooperation and development of society, aimed by the Islamic financial system. Thirdly, local farming will be concentrated more in terms of financing than other sectors of agriculture like livestock, dairy farming, fish farming, horticulture, poultry farming etc. Fourthly, ground realities are against the provision of securities as majority of farmers belong to lower class, and consequently, are not in position to provide securities and other forms of collaterals. Therefore, some other techniques should be followed by the financial institution for the protection of their liquidity. The best possible solution in this regard may be the provision of personal or group based securities. Fifthly, very simple and accurate procedure will be followed for the provision of financing facility and the best possible efforts will be made for the reduction of transactional costs. Sixthly, Majority of farmers (respondents) do not accept the arrangement of customer agency and unwilling to become agent of the bank. The possible solution is that any other farmer, not the customer, of the same locality can be appointed by the bank as its agent. The appointment of such farmer, other than the customer, is the ideal solution in the sense that the bank will not have to buy the commodity itself, and will also avoid customer's agency, which is not advisable from *Sharī ʻah* perspective. Seventhly, being a regulatory body, the State Bank should strictly bar the Islamic financial institutions not to charge interest in any form; and in case of violation, some serious actions should be taken against them. Such actions may start from pecuniary punishment to the extent of cancellation of registration. As a matter of fact, the advisory type of guideline may not be a successful strategy to prevent Islamic financial institutions from indulging in interest based transactions, directly or indirectly. They may

simply change the term "interest" with "profit" and the term "rescheduling" with "penalty for the default of payment". Eighthly, the eligibility and creditworthiness criteria should be relaxed to a great extent so that poor farmers may get more benefit from all financing schemes offered by the Islamic financial institutions.

BIBLIOGRAPHY

Aamir Riaz, Ghazanfar Ali Khan, Munir Ahmad, *Utilization of Agriculture Credit by the Farming Community of Zarai Tariqiati Bank Limited (Ztbl) For Agriculture Development*, Pak. J. Agri. Sci., vol. 49(4).

Abdul Waheed Bhutto ,Aqeel Ahmed Bazmi, *Sustainable Agriculture and Eradication of Rural Poverty in Pakistan*, Natural Resources Forum 31 (2007) 253–262, www.ciitlahore.edu.pk/Papers/173 8589019295997357795.pdf(accessed: 20th March, 2014).

Abdullah Yūsuf Alī, *the Holy Qur'ān* (original Arabic text with English translation).

Abdullah ibn Qudāmah al-Maqdisī, *Al-Kafī,* 5th Edition, (Beirut: Al-Maktab al-Islāmī, 1988).

Abid Shohab Ahmed, Agri Overview, *Agriculture of Pakistan & Microfinance*. http://www.pakissan.com/.../agri.overview/agriculture.of.pakistan.shtml (accessed: 28th February, 2014).

Ab. Aziz, Muhammad Ridhwan, *Agriculture in Islam from the Perspective of Economics, Banking & Finance*. Penerbit UTM, Skudai, Johor Bahru, 2012, ISBN 978–983–52–0840–9.

Abū al-Walīd Muhammad ibn Ahmad ibn Rushd, *Bidāyt al-Mujtahid wa Nihāyat al-Muqtasid*, Vol. 2, 1st Edition. (Beirut: Dār al-Fikr Labnan, 2003).

Abū Bakar Muhammad ibn Abī Sahal Sarakhsī, *Al-Mabsūt,* (Beriut: Dar-Ehyā al-Turāth al-Arabi, Edition.2002).

Abū Bakr ibn Mas'ūd al-Kāsānī, *Bādā'i'al-Sanā'i*',1st Edition, (Beirut: Dār al-Fikr Labnan, 1996), Kitāb-al Sharikah.

Abu Umar Faruq Ahmad, *Theory and Practice of Modern Islamic Finance: the Case Analysis from Australia* (United States, Florida, Brown Walker Press Boca Raton, 2010), p.200.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) 2010, Bahrain, English Version, http://www.aaoifi.com (accessed December 25, 2011)

Adam B. Elhiraika, Sayed A. Ahmed, *Agricultural Credit Under Economic Liberalization and Islamization in Sudan*, The African Economic Research Consortium, AERC Research Paper 79, African Economic Research Consortium, Nairobi March 1998,p.10

Adam B. Elhiraika, "*Risk-Sharing and the Supply of Agricultural Credit: A Case Study of Islamic Finance in Sudan*, Journal of Agricultural Economics, “47/1-4 (1996): 390-402

Adam B. Elheraika, *On the Experience of Islamic Agricultural Finance in Sudan: Challenges and Sustainability (*Jeddah: Islamic Research and Training Institute Islamic Development Bank, 2003), 74 , Reviewed by Ahmed S. Bamakhramah, Faculty of Economics and Administration Department of Economics King Abdulaziz University Jeddah, Saudi Arabia

Adedapo, K. D. "*Analysis of Default Risk of Agricultural Loan by Some Selected Commercial Banks in Osogbo, Osun State, Nigeri*, International Journal of Applied Agriculture and Apiculture Research, vol 4, no. 1&2 (2012).

Adeleke Salami, *Damilola Felix Arawomo, - Empirical Analysis of Agricultural Credit in Africa: Any Role for Institutional Factors*, Working Paper 192, www.afdb.org/.../working-paper-192-empirical-analysis-of-agricultural-. (accessed: 2nd May , 2014).

Adnan Qadir ,*A Study of Informal Finance Markets In Pakistan*, (with a study of SMEs) by Dr. Faisal Bari and Adeel Faheem and a survey by the Punjab Economic Research Institute, Pakistan Microfinance Network ,December 2005,www.microfinanceconnect.info/assets/articles/informal.pdf(accessed: 13th April 2014).

Agricultural Finance Program, Department of Agricultural Economics, October 1989 And Rural Sociology The Ohio State University Annotated Bibliography On Agricultural Credit And Rural Savings: Xiii (A special Issue On Informal Finance), p.3, http:// pdf.usaid.gov/pdf_docs/PNABJ788.pdf (accessed June 21st, 2014).

Agriculture Sector in Pakistan, Food and Agriculture Organization of the united nation October .1998,http://www.pakissan.com/english/agri.../fao.agricultural.sector.pakistan1.shtml(accessed: 28th February , 2014).

Ahmad Fraz Khan ,*Skewed agricultural loans*, The Dawn News, Published Feb 24, 2014 07:41am, http://www.dawn.com/news/1089051(accessed: 10th August , 2014).

Ahmad Kaleem, Rana Abdul Wajid, (2009) "*Application of Islamic Banking Instrument (Bay‘ Salam) for Agriculture Financing in Pakistan*", British Food Journal, vol. 111, issue: 3, pp.275 – 292.

Ahmad Kaleem and Salma Ahmad, *Bankers' Perception Towards Bay' Salam Method for Agriculture Financing in Pakistan*, Journal of Financial Services Marketing 15,pp. 215-227 (December 2010).

Ahmad Kaleem, *Outlook for Islamic Financing of Agriculture*, March 2007, http://www.pakissan.com/.../outlook.for.islamic.financing.of.agriculture.shtml (accessed: 15th February , 2014)

Aja Okorie and Andrew C. Iheanacho, *Agricultural Loan Recovery Strategies In A Developing Economy: A Case Study of Imo State, Nigeria,* African Review of Money Finance and Banking, No. 2 (1992), pp. 195-202, http:// www.jstor.org/stable/23027471, (accessed: April 6,2013)

Ali Yasseri, *The Experience of the Islamic Republic of Iran in Mushārakah Financing*, Arab Law Quarterly, 14/3 (1999): 231-224.

Al-Hashimi, Muhammad Ali Alula, 1989.*The Influence of Islamic Banking on Agricultural Development in Sudan*,Graduate Research Masters Degree Plan B Papers 10994, Michigan State University, Department of Agricultural, Food, and Resource Economics.

Allma Syed Muhammad Ibn Ismaeel Alsānanī, *Subul –al- Salam,* Urdu Translation by Abdul Qayoom,Sharia Accademy, International Islamic Unioversity Islamabd,First Edition.2004,Bab-al –Riba ,p.86

Amy M. Nagler, Dale J. Menkhaus, Christopher T. Bastian, Mariah D. Ehmke, *Subsidy Incidence in Agricultural Land Markets: An Experimental Investigation,* (Selected Paper prepared for presentation at the Agricultural & Applied Economics Association's 2011 AAEA & NAREA Joint Annual Meeting, Pittsburgh, Pennsylvania, July

24-26, 2011), http:// ageconsearch.umn.edu/.../Subsidy%20Incidence_AAEA%20Selected%2. (accessed November 1st , 2013).

Andrew Dorward, Peter Hazell ,Colin Poulton, *Rethinking Agricultural Input Subsidies in Poor Rural Economies,* September 2007,Future Agriculture, http:// www.future-agricultures.org/.../22-rethinking-agricultural-input-subsidie(accessed December 30, 2013).

Andrew Dillon,Valerie Mueller,Sheu Salau, *Migratory Responses to Agricultural Risk in Northern Nigeria*, IFPRI Discussion Paper 01007,July 2010, International Food Policy

Research Institute, http:// www.ifpri.org/sites/default/files/publications/ifpridp01007.pdf(accessed: 16th February , 2014).

Antonio La Vina, Lindsey Fransen Paul Faeth ,Yuko Kurauchi, *Reforming Agricultural Subsidies:" No Regrets" Policies for Livelihoods and The Environment*, World Resource Institute, pdf.wri.org/reforming_ag_subsidies.pdf (accessed December 30, 2013).

Ani L. Katchova and Peter J. Barry. *Credit Risk Models and Agricultural Lending, American* Journal of Agricultural Economics, vol. 87, no. 1 (Feb., 2005), pp. 194-205, Oxford University Press on behalf of the Agricultural & Applied Economics Association;

Aniss Boumediene, *is Credit Risk Really Higher in Islamic Banks*?, The Journal of Credit Risk ,vol.7, no. 3, Fall 2011,p.103.

Ashok Gulati ,Seema Bathla, *Institutional Credit to Indian Agriculture: Defaults and Policy optiotions*, Occasional Paper 23, National Bank for Agriculture, and Rural Development, Mumbai 2002, https://www.nabard.org/pdf/OC%2023.pdf(accessed June 5th , 2014).

Ausaf Ahmad, *Contemporary Practices of Islamic Financing Techniques*, Islamic Research and Training Institute, Islamic Development Bank, Jeddah, Saudi Arabia,Research Paper No. 20.

Aziz Elbehri, *Agricultural Export Subsidies*, http:// www.gtap.agecon.purdue.edu/resources/download/643.pdf (accessed November 22, 2013).

Aziz Elbehri Susan Leetmaa, *How Significant are Export Subsidies to Agricultural Trade? Trade and Welfare Implications of Global Reforms*, Paper presented as a Selected Paper at the 5th Annual Conference on Global Economic Analysis, June 5-7, 2002, Taipei, Taiwan http:// ageconsearch.umn.edu/bitstream/20518/1/sp01el02.pdf(accessed December 30, 2013).

Betty Kibaara and James Nyoro, *Expanding the Agricultural Finance Frontier: A Kenyan Case,* AAAE Conference Proceedings (2007) 287-290, http://ageconsearch.umn.edu/bitstream/52109/2/Kibaara.pdf(accessed August 22, 2013).

Brian B. Kettell, *Introduction to Islamic Banking and Finance*, (John Wiley & Sons, 2011).

Bruce J. Sherrick, Peter J. Barry and Paul N. Ellinger, *Valuation of Credit Risk in Agricultural Mortgages*,American Journal of Agricultural Economics, vol. 82, no. 1 (Feb., 2000), pp. 71-81, Oxford University Press on behalf of the Agricultural & Applied Economics Association

*Bukhari*English version, translated by Muhammad Mohsin Khan, (1986) Islamic University alMedina al Munawarah, Kazi Publication Pakistan, sixth Edition

Burhānu Din abī al Hasan Ali Ibni Abī Bakar al Marghinānī , *Al Hidāyah Sharh Bidāyat ul Mubtadī*,(Karachi,Pakistan ,Maktabatul Bushra ,Second Edition 2008)

Burtn Fosom JR, *The Origin of American Farm Subsidies*, http://brent.fm/wp-content/.../farmer-government-subsidies-0604-folsom.pdf (accessed November 22, 2013).

Carlos Mulas-Granados, Taline Koranchelian, and Alex Segura-Ubiergo, *Reforming Government Subsidies in the New Member States of the European Union*, IMF Working Paper July 2008, https://www.ucm.es/data/.../5-Reforming%20government%20FMI.pd(accessed December 30, 2013).

Caroline Franck, Sonia M. Grandi, Mark J. Eisenberg, *Agricultural Subsidies and the American Obesity Epidemic*, (Under Embargo Until July 9, 2013, 12:01 Am Et), http:// www.ajpmonline.org/webfiles/images/.../3834-stamped-070913.pdf (accessed December 30, 2013).

Catherine Guirkinger, *Understanding the Coexistence of Formal and Informa Credit Markets in Piura, Peru*, Center for Research in Economic Development University of Namur, Belgium September 2006, p.2, https://pure.fundp.ac.be/ws/files/1016771/58150.pdf(accessed October 16, 2013)

Calum G. Turvey, Rong Kong, *Informal Lending Amongst Friends and Relatives: Can Microcredit Compete in Rural China?*,Paper Submitted for CERMI, First European Research Conference on Microfinance 2-4 June 2009, Brussels, Belgium Wednesday, March 25, 2009.

Calvin Miller, Microcredit and *Crop Agriculture: New Approaches, Technologies and other Innovations to Address Food Insecurity among the Poor*, 2011 Global Microcredit Summit Commissioned Workshop Paper November 14-17, 2011 – Valladolid, Spain

Christopher B. Barrett, *The Economics of Agricultural Development: An Overview*, p.3, http://dyson.cornell.edu/.../Introduction%20Chapter%201%208June2011%20(accessed june29, 2013)

Committee on Customer Service in Banks,Reserve Bank of India,http://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=645(accessed : 20th March, 2014).

Dale W. Adams, *Agricultural Credit in Latin America: A Critical Review of External Funding Policy*, American Journal of Agricultural Economics, Vol. 53, No. 2 (May, 1971), pp. 163-172.

Devaraja T.S., (Post Graduate Department of Commerce University of Mysore Hassan, India) *An Analysis of Institutional Financing and Agricultural Credit Policy in India* (The work described in this working paper was substantially supported by a grant from the University Grants Commission of India), May 2011,pp.14-15

Dimitri Germidis, *Savings and Development*. vol. 14, no. 1 (1990), pp. 5-22, Giordano Dell-Amore Foundation Article Stable URL: http://www.jstor.org/stable/25830210(accessed June 21st, 2014)

Draft Guideline for Livestock Financing, Agricultural Credit Department, the State Bank of Pakistan, p.1, http://www.sbp.org.pk/acd/2006/Guidelines_Livestock_C1.pdf
www.sbp.org.pk/acd/2006/Draft-Gls-Livestock-Financing.pdf(accessed: 28th February , 2014).

Ejaz Ahmad Samdani, *Islamic Banking and Murābahah*,(Karach,Pakistan,Darul-Ishaat,First Edition ,2008), p.16.

Elizabeth Coffey, *Agricultural Finance: Getting the Policies Right, Agricultural Finance Revisited*, Food and Agriculture Organization of the United Nations (FAO), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)NO, 2, June 1998, p.5.

Eric Holt-Gim nez, *The World Food Crisis: What is BehindiIt and What We Can Do*, http://www.worldhunger.org/articles/09/editorials/holt-gimenez.htm (accessed July 30, 2013).

Executive Summary, State Bank of Pakistan http://, www.sbp.org.pk*/report/ExecutiveSummary.pdf* (accessed May 21st, 2014)

Ezzedine Mohd. Khoja ,*Instruments of Islamic Investments* , Dallah Al-Baraka Group Research & Development Department Instruments of Islamic Investment http:// www.iefpedia.com/english/wp.../Instruments-of-Islamic-Investments.pdf (accessed July 15,2012).

Fahim Patel, *Agriculture and Its Problems in Pakistan*, Guess Papers,http://www.guesspapers.net › Class XII › XII Commercial Geography(accessed: 5th April 2014).

Fazal Wahid Zia Ur Rehman, *Share of the Informal Loans in Total Borrowing in Pakistan: A Case Study of District Peshawar*, Journal of Managerial Sciences, vol. VIII, p.103.

Financing Scheme for Small Farmers , Agricultural Credit Department, State Bank of Pakistan(accessed: 28th February , 2014);

Firoja Akter Khanam, Kamrul Hasan, *Evaluation of Management of Agricultural Credit – A Case Study on Bangladesh Krishi Bank*, Journal of Education and Practice www.iiste.org ISSN 2222-1735 Paper) ISSN 2222-288X (Online) vol.4, no.13, 2013.

Fred Gale, Bryan Lohmar, Francis Tuan, *China's New Farm Subsidies, F Electronic Outlook Report from the Economic Research Service*, http:// www.ers.usda.gov/ersDownloadHandler.ashx?file=/media/872040/ accessed December 30, 2013).

Frequently Asked Questions (FAQs) On Agri Financing ,Agricultural Credit Department Islamic Banking Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/ACD_FAQs.pdf(accessed: 28th February , 2014).

Guidelines on Islamic Finance for Agriculture, the Agricultural Credit Department, Islamic Banking Department, State Bank of Pakistan, http:// www.sbp.org.pk/guidelines/IslamicAgriculture/Guidelines-Islamic-Financing-Agriculture-01-09-2008.pdf (accessed: 28th February, 2014).

Guidelines for Horticulture Financing, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/guidelines/Horticulture/Horticulture_Guideline.pdf (accessed: 28th February, 2014).

Guidelines for Poultry Financing, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2007/Draft-Guidelines-Poultry-Financing.pdf (accessed: 28th February, 2014).

Guidelines for Fisheries Financing, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2007/Guidelines-for-Fisheries-Financing.pdf (accessed: 28th February, 2014).

Guidelines for Livestock Financing, the Agricultural Credit Department, State Bank of Pakistan, http://www.sbp.org.pk/acd/2006/Guidelines_Livestock_C1.pdf (accessed: 28th February, 2014).

Gonzalo Pastor and Ron Van Rooden, *Turkmenistan: The Burden of Current Agricultural Policies,*M.E. Sharpe, Inc, Emerging Markets Finance & Trade, vol. 40, no. 1 (Jan. - Feb., 2004), pp. 35-58.

Gwyn E. Jones, Chris Garforth, *the History, Development, and Future of Agricultural Extension,* Chapter 1, Natural Resources Management and Environment Department, 1997, http://www.fao.org/docrep/W5830E/w5830e03.htm (accessed April 10, 2013).

Handbook on Best Practices in Agri/Rural Finance, Agricultural Credit Department State Bank of Pakistan, p.6, http://www.sbp.org.pk/acd/Handbook-Best-Practices-Agri-Rural-Finance.pdf(accessed: 22th March, 2014).

Haroon Rasheed ,Muhammad Mudassar, *Research on Innovative Models of Islamic Banking Product for Pakistani Farmers*, Proceedings of the 7th International Conference on Innovation & Management,http://www4.pucsp.br/.../26_Research%20on%20Innovative%20Models%20of(accessed:22nd February , 2014).

Harsha de Silva, A*n Innovative Fruit and Vegetable Market in formation System in Sri Lanka: The Govi Gnana (Farmer Knowledge) Service*, Presented at the USAID and World Bank sponsored Workshop: Inaugurating New Partnerships in the Global Food Chain at the 15th Annual World Food and Agribusiness Forum, Symposium and Case Conference, Chicago, USA. http://globalfoodchainpartnerships.org/cairo/papers/HarshadeSilvaSriLanka.pdf(accessed: 29th March, 2014);

Harsha de Silva and Dimuthu Ratnadiwakara, *Using ICT to Reduce Transaction Costsin Agriculture through Better Communication: a Case-Study from Sri Lanka*, http://

www.ifrneasia.net/wp-content/uploads/2008/11/transactioncosts.pd (accessed October 22, 2013).

Hassan Yusuf Dawood, *Al Masraf ul Islāiī lil Istismāre al Zirāī*' " Namozaj Muqtareh" , Dra al Nushr lil Jameat Misr(Al Qahera), 1st Edition 2005

Hiroyuki Takeshima and Hak Lim Lee, *Monitoring and Evaluation of Agricultural Subsidy Program*, http:// www.ifpri.org/sites/default/files/publications/mssppn2.pdf (accessed December 30, 2013).

Hishamunda, N.; Manning, P, *Promotion of sustainable commercial aquaculture in sub-Saharan Africa, Tackling the Issues of Collateral and High Interest Rates,* chapter.4 vol.2: Investment and economic feasibility.FAO Fisheries Technical Paper. No. 408/2. Rome, FAO. 2002, p. 54.

Hossein Askari, Zamir Iqbal, Abbas Mirakhor, *New Issues in Islamic Finance & Economics,* (1st Ed.) Singapore: John Wiley & Sons, 2009 (pp197-210).

Hossein Mahdavi Najmabadi, *Proposal for a Modified Model of Musharakah Financing, with Emphasis on Iran*", Arab Law Quarterly, vol. 14, no. 3 (1999), pp. 282-301 http://www.jstor.org/stable/3382085. (accessed November 7,2012).

Ibn Hazm al Zaherī. Al Muhallah, *Dar-al-Fikr*, Berut Lubnan, 1st Edition 1988

Ibn ʻĀbidīn, Radd al-Mukhtār, (Beirut: Dār al-Fikr, 2005).

Ibn HajarAsqalani. *Fath al Barī –fī- Sharh Saheeh- al -Bukharī*, Dar ul Misr Litabat, First Edition 2011, pp.88-89.

Imran Sharif Chaudhry, Shahnawaz Malik, Muhammad Ashraf, *Rural Poverty in Pakistan Some Related Concepts, Issues and Empirical Analysis,* Pakistan Economic and Social Review vol.44, no. 2 (Winter 2006), pp. 259-276.

Imaduddin, *NBP to open 40 new branches in rural areas,* Wednesday, 13 March 2013 03:26, Business Recorder, www.brecorder.com › Pakistan › Banking & Finance(accessed: 23th March, 2014).

Inayatullah Jan, Sania Munir, Abid Usman, Muhammad Idrees, *Agricultural Credit Markets in Northwest Pakistan:Implications for the Development Policy*, Sarhad J. Agric. vol.28, no.3, 2012.

Information pertaining to Rural Credit, Priority Sector Advances, and Financial Inclusion etc. http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=624 (accessed: 22nd July 2014).

Innovative Agricultural SME Finance Models, International Finance Corporation November 2012, p.15, http://www.ifc.org/wps/.../Innovative+Agricultural+SME+Finance+Models.pdf. (accessed june 29, 2013).

Irma C. Corales and Carlos E. Cuevas, *Cost of Agricultural Credit in the Philippines: the Short-Run Effects of Interest Rate Deregulation,* Working Paper Series No. 87-02, http:// dirp4.pids.gov.ph/ris/wp/pidswp8702.pdf (accessed October 17, 2013).

Jason Clay, *Are Agricultural Subsidies Causing More Harm than Good?,*Guardian Professional, August 2013

, http:// *www.theguardian.com* › Professional › Guardian Sustainable Business (accessed November 17, 2013).

Jerome M. Wolgin, *Resource Allocation and Risk: A Case Study of Smallholder Agriculture in Kenya,* American Journal of Agricultural Economics, vol. 57, no. 4 (Nov., 1975), pp. 622-630, Oxford University Press on behalf of the Agricultural & Applied Economics Association.

J. Howard M. Jones, *Informal finance and rural finance policy in India: historical and contemporary perspectives*, Contemporary South Asia, vol.16, issue 3.

Jochem Zoetelief, *Perspectives on Informal Rural Finance*,, Posted September 1999,Food and Agricultural Organization of the United Nation, http:// www.fao.org/sd/ppdirect/ppan0015.htm(accessed June 5th , 2014)

Johan F. M. Swinnen and Hamish R. Gow, *Agricultural Credit Problems and Policies During the Transition to a Market Economy in Central And Eastern Europe,* Policy Research Group Working Paper No. 61997,p.4.

John Lingard, *Agricultural Subsidies and Environmental Change*, , http:// www.wiley.com/legacy/wileychi/egec/pdf/GB403-W.PDF(accessed December 30, 2013).

Kadidia Konare, *Challenges to Agricultural Financing in Mali,A Plan B* Paper Submitted to Michigan State University in partial fulfillment of the requirements for the degree of Master Of Science Department of Agricultural Economics

2001,http://fsg.afre.msu.edu/mali_pasidma/Kohare_Challenges_Ag_Financing.pdf(accessed May 21st, 2014).

Kari Hamerschlag,*Farm Subsidies in California:Skewed Priorities and Gross Inequities,* http://farm.ewg.org/pdf/california-farm.pd(accessed December 30, 2013).

Kasānī .*Badia-al-Sanai fi Tarteeb-al-Sharai*, Daru-al-Fikr, Beroot Labnan, 1st Edition1996,

Kazem Sadr, Mohammad-Ali Kafaie, Bahram Haidari, *Islamic Agricultural Finance and Growth*, http:// ier.ut.ac.ir/?_action=showPDF&article=31007&_ob...full. (accessed: 16th February , 2014).

Kazim Sadr ,*The Role of Musharakah Financing in the Agricultural Bank of Iran*, Arab Law Quarterly, Vol. 14, No. 3 (1999), pp. 245-256 .http://www.jstor.org/stable/3382082 (accessed June7th,2012).

Kewal Kumar and Atul Gambhir, *Financing of Agriculture by Commercial banks – Problems Faced by Farmers (An Empirical Study*), vol.1, issue no.5 http://www.abhinavjournal.com/images/Commerce.../May12/10.pdf(accessed October 16, 2013).

Khalid S. Mohamed and Andrew E. Temu, Bergamo, *Access To Credit and its Effect on the Adoption of Agricultural Technologies: The Case of Zanzibar,* African Review of Money Finance and Banking, (2008), Research Center on International Cooperation of the University of Bergamo, pp. 45-89, http://www.jstor.org/stable/41410533 . (accessed July 15th , 2013).

Khawaja Amjad Saeed,*Islamic Banking in Pakistan: A Review of Conventional and Islamic Banking*, Proceedings of 2nd International Conference on Business Management (ISBN: 978-969-9368-06-6), pp.7,8, umt.edu.pk/icobm2012/pdf/2C-95P.*pd*/(accessed: 21st August, 2014).

Lamon Rutten,*Innovative Agricultural Finance and Risk Management Strengthening Food Production And Trade in the Transition Region*, Working Paper, Prepared under the FAO(Food and Agriculture Organization of the United Nations) /EBRD(European Bank for Reconstruction and Development Cooperation),p.28

Laurence M. Crane & David J. Leatham, *Profit and Loss Sharing in Aagriculture: An Aapplication of Islamic Banking,* Vol. 9/4, (Agribusiness, 1993), pp. 403-412.

Laws of Malaysia Act 276, Islamic Banking Act 1983,http://www.bnm.gov.my/documents/act/en_ib_act.pdf - Cached (accessed November 24, 2012).

Lolita Y.Poliquit ,*Accessibility of Rural Credit among Small Farmers in Philippine ,2006*, Massey University Palmerston, Newzeland, http:// mro.massey.ac.nz/bitstream/handle/10179/1687/02_whole.pdf?...1 (accessed: 26th March, 2014).

Lutfullah Saqib; Kellie W. Roberts; Mueen A. Zafar; Khurram Khan;Aliya Zafar, Mushārakah—A *Realistic Approach to the Concept in Islamic Finance and its Application to the Agricultural Sector in Pakistan*, Arab Law Quarterly, Volume 28, Issue 1, 2014,pp.: 1–39 (39).

Lutfullah Saqib, *Financing Agriculture Through Islamic Commercial Transaction*, 1st Edition 2011.,Lambert Academic Publishing, Germany).

Magda Ismail Abdil Muhsin, *The Practice of Islamic Banking System in Sudan*,Jounal of Economic Cooperation 26 (4) 2005, pp .27-50. http://www.sesric.org/jecd/jecd_articles/ART05070102-2.pdf (accessed March 10 ,2012).

Mahmoud A.Gulaid, *Financing Agriculture Through Islamic Modes And Instrument: Practical Scenario And Applicability*, (Jeddah Saudi Arabia : Islamic Research And Training Institute Islamic Development, Bank, 1995) ResearchNo.34

Mahmood Ahmdad Ghazi, *Muhazarāt-e-Fiqh*, Al Faisal Nashran, Lahore 2005, pp106-107.

Manfred Zeller, *Models of Rural Finance Institutions*, Invited lead paper for the

International Conference on Best Practices in Rural Finance June 2-4, 2003 in Washington, D.C., institute of Rural Development Waldweg 26 37073 Göttingen, Germany, http://www.gwdg.de/~uare(accessed June 21st, 2014).

Manzer Khaif and M.Faheem Khan,*Short Term Financing of Commodity Production in Islamic Perspective*, Paper had to be presented to the seventh annual meeting of the expert of Islamic banking ,Kualalumpur,spring 1992. http://monzer.kahf.com/papers.pdf (accessed March 8 ,2012).

Marek Hudon, *Fair Interest Rates When Lending to the Poor*,(2007),FNRS Research Fellow Solvay Business School, Université Libre de Bruxelles, Ethics and Economics, 5, 1, pp. 1-8,

Martin Prowse, *Contract Farming in Developing Countries - A Review*, Savoir collection , 2010 , AFD's Research Department, www.afd.fr/webdav/shared/PUBLICATIONS/.../12-VA-A-Savoir.pdf (accessed August 29 , 2013).

Matthias Bickel, Martin Klein, *Rethinking Rural and Agricultural Finance –The African Case,* international Platform, , https:// www.rural21.com/.../R21_Rethinking_rural_and_agricultural_finance_0... (accessed: 17th March, 2014).

Mats Lundahl and Lucian A. Msambichaka, *Agricultural Credit in Tanzania 1961-1966* / Le Crédit Agricole En Tanzanie1961-66, Savings and Development, vol. 13, no. 2 (1989), pp. 149-168.

Mazhar Ali Bokhari, *Introduction to Islamic Banking*, 2010, AlHuda CIBE Awareness workshop B.Z University –Multan.Avialblea, http://www.alhudacibe.com.Presentations %20on%20Islamic%20Banking%20and%20Finance (accessed November 24, 2012).

M.Ghaffar Chaudhry, Shamim A. Sahibzada, *Agricultural Input Subsidies in Pakistan: Nature and Impact*, The Pakistan Development Review 34 : 4 Part II (Winter 1995) pp. 711—722, http://www.pide.org.pk/pdr/index.php/pdr/article/view/1399/1372(accessed November 22, 2013).

M. Irfan,G. M. Arif,Syed Mubashir Ali,Hina Nazli, *The Structure of Informal Credit Market in Pakistan,*Research Report No. 168, Pakistan Institute of Development Economics, http:// www.pide.org.pk/pdf/rr/RR168.pdf(accessed: 19th April , 2014).

Manojit Bhattacharjee, Meenakshi Rajeev, *Interest Rate Formation in Informal Credit Markets in India: Does Level of Development Matter?,* BWPI Working Paper 126, September 2010,p.3.

Maqbool Hussain Sial, Masood Sarwar Awan, Muhammad Waqas, *Role of Institutional Credit on Agricultural Production,A Time Series Analysis of Pakistan*, International Journal of Economics and Finance, vol. 3, no. 2; May 2011.

Michael Winn, Calvin Miller, Ivana Gegenbauer, *The Use of Structured Finance Instrumentsin Agriculture in Eastern Europe and Central Asia*, Agricultural Management, Marketing and Finance Service (AGSF) Rural Infrastructure and Agro-Industries Division ,Food And Agriculture Organization of the United Nations Rome, 2009 http://www.ruralfinance.org/.../1255015522845_WD_26_ECA_v4_per_web.pdf(accessed August 17, 2013).

Mirza vejzagic, Edib Smolo ,*Maqāsid-al- Sharī`ah in Islamic Finance- An Overview* ,http://www.academia.edu/1146010/Maqasid_AlShariah_in_Islamic_Finance_An_Overview(accessed: 25th August , 2014).

Mittal, Rashi, and S. P. Singh. *"Shifting from Agriculture to Agribusiness: The Case of Aromatic Plants*." Agricultural Economics Research Review 20, no. 2007 (2007), vol.4, pp 541-550.

Mir Kalan Shah, Humayun Khan, Jehanzeb ,Zalakat Khan, *Impact of Agricultural Credit on Farm Productivity and Income of Farmers in Mountainous Agriculture in Northern Pakistan: A Case Study of Selected Villages in District Chitral*, Sarhad J. Agric. vol.24, no.4, 2008.

Mohammad H. Mondal, *Crop Agriculture of Bangladesh: Challenges and Opportunities*, Bangladesh J. Agril. Res. 35(2), pp.235-245, June 2010.

Mohammad Rashrash Mustafa, *Some Features of Rural Finance in the Near East and North Africa Region - Studies and Remarks* – Amman, Jordan 2004 , Near East North Africa Regional Agricultural Credit Association (NENARACA), 2nd Edition.

Mohammad Nejatullah Siddiqi, *Partnership and Profit-Sharing in Islamic Law*, (Leicester,UK The Islamic Foundation, 1985), p-22-23.

Mohammad Hashim Kamali,*Maqasid al Shariah: The Objectives of Islamic Law*, http://www.sunniforum.com/forum/showthread.php?6176-Maqasid-al-Shariah-The-Objectives-of-Islamic-Law(accessed: 25th August, 2014).

Mohammad Omar Farooq, Qard Hasan, *Wadiah/Amanah and Bank Deposits: Applications and Misapplications of Some Concepts in Islamic Banking*, Arab Law Quarterly, 25 (2). 2010 Available at SSRN: http://ssrn.com/abstract=1418202. (accessed July 11, 2011).

Mohsin Ali, *Agriculture Problems in Pakistan and Their Solutions,* March 1st 2010, http:// www.einfopedia.com/agriculture-problems-in-pakistan-and-their-solutions.php (accessed January,2013)

Montek S. Ahluwalia ,*Policies for Poverty Alleviation,* Asian Development Review ,Studies of Asian and Pacific Economic Issues; vol. 8 no. 1; 1990.

Muhammad Iqbal, Munir Ahmad, Kalbe Abbas and Khalid Mustafa, *The Impact of Institutional Credit on Agricultural Production in Pakistan,* The Pakistan Development Review, vol. 42, no. 4, Papers and Proceedings PART II Nineteenth Annual General Meeting and Conference of the Pakistan Society of Development Economists Islamabad, January 13-15, 2004 (Winter 2003), pp. 469-485, Pakistan Institute of Development Economics, Islamabad, http://www.jstor.org/stable/41260420. (accessed: July 4,2013).

Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq, Malka Yasmeen, *Role of Islamic Banking in Agriculture Development in Bahawalpur, Pakistan* ,International Journal of Learning & Development ISSN 2164-4063 2012, vol. 2.

Muhammad Taqi Usmani, *An Introduction to Islamic Finance,* (Karachi: Maktaba Ma'ariful Quran, Edition August 2008)

Muhammad Khalid Bashir and Muhammad Masood Azeem, *Agricultural Credit in Pakistan: Constraints and Options*, Pak. j. life soc. sci. (2008), 6(1): 47-49.

Muhammad Asif Naveed, Mumtaz A. Anwar, Surraya Bano, *Information Seeking by Pakistani Farmers: A Review of Published Research,* Pakistan Journal of Library & Information Science, 13 (2012),p.5 , http:// pu.edu.pk/images/journal/pjlis/pdf/pjlis-13-naveed.pdf(accessed: 21th March , 2014).

Muhammad Zakria Zakar1, Rubeena Zakar, *Diffusion of Information Technology for Agricultural Development in the Rural Punjab: Challenges and Opportunities,*Pakistan Vision, vol.9 no.2,p.169.

Muhammad Tahir Mansoori, *Islamic Law of Contracts and Business Transactions,* (Islamabad: Sharī'ahAcademy International Islamic University, 3rd Edition, 2006.

Munir Ahmad, Caesar Cororaton, Abdul Qayyum, Muhammad Iqbal, *Impact of Domestic Policies towards Agricultural Trade Liberalization and Market Reform on Food Security*

in Pakistan, International Conference on "Trade Liberalization and Food Security in South Asia: The Lessons Learnt New Delhi, India, June 8-9, 2006.

M. Sharif Zia, TariqMahmood, Mirza B. Baigand M. Aslam, *Land and Environmental Degradation and Its amelioration for Sustainable Agriculture in Pakistan*, Quarterly Science, Vision vol.9, no.1-2 (Jul - Dec, 2003) & 3-4 (Jan - Jun, 2004),p.1.

Muhammad Khalid Bashir,Yasir Mehmood,,Sarfraz Hassan , *Impact of Agricultural Credit on Productivity of Wheat Crop: Evidence from Lahore*, Punjab, Pakistan, Pak. J. Agri. Sci., vol. 47(4), pp.405 -409.

M. Sharif Zia, TariqMahmood, Mirza B. Baigand M. Aslam, *Land and Environmental Degradation and Its amelioration for Sustainable Agriculture in Pakistan*, Quarterly Science, Vision vol.9, no.1-2 (Jul - Dec, 2003) & 3-4 (Jan - Jun, 2004),p.1.

Muhammad Faheem Khan, *Islamic Future and Their Markets, with special Reference to their Role in Developing Rural Financial Market,* Islamic Development bank, Islamic Research and Training Institute, Paper no.32, p.41. http://www.irtipms.org/OpenSave.asp?pub=33.pdf(accessed July 14,2012)

Muhammad Tahir Mansoori,*Use of Hiyal in Islamic Finance, journal of Islamic Business and Management,* Riphah International University Islamabad Pakistan, Issue No.1,November 1st 2011 ,vol.1.

Muhammad Ali Alula Al-Hashmi, *The Influence of Islamic Banking on Agricultural Development in Sudan, A plan B* Paper, Submitted to Michigan State University, Department of Agriculture Economics 1989. http:// ageconsearch.umn.edu/bitstream/10994/1/pb89al02.pdf(accessed: 28th February , 2014).

Muhammad Wasif Siddiqi, Mazhar-ul-Haq, Kishwar Naheed Baluch, *Institutional Credit: A Policy Tool for Enhancement of Agricultural Income of Pakistan,* International Research Journal of Arts & Humanities (IRJAH) vol. 37 ISSN: 1016-9342,p.158, http:// www.usindh.edu.pk/irjah/.../11.%20Muhammad%20Wasif%20Siddiqi.p(accessed October 18, 2013).

Muhammad Khalid Bashir and Muhammad Masood Azeem, *Agricultural Credit in Pakistan : Constraints and Options,* Pak. j. life soc. sci. (2008), 6(1): 47-49.

Muhammad Ridhwan Ab. Aziz and Muhammad Mohamad Yusoff, *Financing for Agro Projects in Islamic Banks, 2013 International Conference on Agriculture and Biotechnology* IPCBEE vol.60 (2013) © (2013) IACSIT Press, Singapore DOI: 10.7763/IPCBEE. 2013, v.60. 3.

Nabeel Goheer, Micro Finance; *A Prescription for Poverty and Plight of Women in Rural Pakistan, Rural Finance For Growth and Poverty Alleviation*, http://, www.gdrc.org/icm/country/pak-microfinance.pdf(accessed May 21st, 2014).

Nachiket Mor, D Chattanathan and Rajiv Panthary, *Enhancing the Flow of Credit and Managing Risks in Agriculture,* Institute for Financial Management and Research Centre for Development Finance Working Paper Series August 2006,p.18

Naeem Ur Rehman Khattak Khattak and Anwar Hussain Hussain, *A Review of the Principles of Islamic Banking System for Agriculture Credit, Pakistan*, Institute of Development Economics Islamabad Pakistan 2006, MPRA Paper No. 42038, posted 18. October 2012.

Naira Grigoryan, *Agricultural Lending System & Contracts in the Republic of Armenia (Master Paper),* American University of Armenia, 2007, Yerevan, Republic of Armenia, http:// law.aua.am/files/2012/02/Agricultural-Lending.pdf - Cached-(accessed March,2013).

Naushad Khan, Inayatullah Jan, Mujib ur Rehman Anwar Mehmood, Akhtar Alim, *The Effects of Short Term Agricultural Loans Scheme of Zarai Tarraqiati Bank on Increase in Farm Production In District Karak* , Sarhad J. Agric. vol. 23, no. 4, 2007.

Naushad Khan, Malik Muhammad Shaf'ī , Musawar Shah,Ziaul Islam, Mohammad Arif, Rukhsana Javed, Naeem Shah, *Review of Past Literature on Agriculture Credit In Rural Area of Pakistan*, Sarhad J. Agric. vol.27, no.1, 2011,p.104.

New Jersey Agricultural Mediation Program Handbook, a Guide for Farmers, Neighbors and Municipalities, N.J Agricultural Development Committee,p.1,http://nj.gov/agriculture/sadc/agmediation/handbook.pdf(accessed: 30th July , 2014).

Official Newsletter of Pakistan Business Forum, October 2013, Governor SBP Launches Islamic Banking MediaCampaign, p.4, http:// www.pakbforum.com/admin/download/October13.pd(accessed: 15th February , 2014).

Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan, Ministry of Finance, Chapt.2,p.13.

Owuor George, Shem A.O, *Informal Credit and Factor Productivity in Africa: Does Informal Credit Matter?* Selected Poster Prepared for Presentation at the International Association of Agricultural Economists (IAAE) Triennial Conference, Foz do Iguaco, Brazil, 18-24 August, 2012.

Pakistan Launches Media Campaign to Boost Islamic Finance, Reuters, Reported by Bernardo Vizcaino and Edited by Eric Meiger and Michael Perry, Dated on Fri Jul 19, 2013 11:48am IST. http:// in.reuters.com/.../islamic-finance-pakistan-idINDEE96I04320130719 (accessed: 16th February , 2014).

Pakistan's Food and Agriculture Systems, Nathan Associates Inc. for review by the United States Agency for International Development, 2009, p.5.

Paul N. Ellinger and Peter J. Barry, *A Farmer's Guide to Agricultural Credit,* The Center for Farm and Rural Business Finance A Finance-Focused Initiative Providing Information to Farm and Rural Businesses and Their Capital Providers University of Illinois at Urbana Champaign,http://www.farmdoc.illinois.edu/finance/FarmersGuidetoCreditBody.htm(accessed July 18th , 2014).

Paul Francis,Humid Zone *Programme ILCA*, P.M.B. 5320, Ibadan, Nigeria, No. 24–March 1986. http://, www.ilri.org/InfoServ/Webpub/fulldocs/Bulletin24/Land.htm(accessed: 30th March, 2014)

P. D. Jeromi, *Regulation of Informal Financial Institutions: A Study of Money Lenders in Kerala*, Reserve Bank of India Occasional Papers, vol. 28, no. 1, Summer 2007.

Peck Christen and Douglas Pearce, *Managing Risks and Designing Products for Agricultural Microfinance, Features of an Emerging Model*,11th paper, (Printed at IFAD in 2006 with the support of Finnish Supplementary Funds) August 2005, http:// www.ifad.org/ruralfinance/pub/risks.pdf (accessed August 17, 2013)

Peter J. Barry, C. B. Baker and Luis R. Sanint ,*Farmers' Credit Risks and Liquidity Management,* American Journal of Agricultural Economics, vol. 63, no. 2 (May, 1981), pp. 216-227, Oxford University Press on behalf of the Agricultural & Applied Economics Association, http://www.jstor.org/stable/1239557(accessed July 30, 2013)

Prudential Regulations for Agriculture Financing, Agricultural Credit & Microfinance Department State Bank of Pakistan, Updated on 29thJanuary, 2014, Regulation no.4, p.8 http://www.sbp.org.pk/publications/prudential/PRsAgriApproved.pdf, (accessed: 28th October , 2014).

Rakesh Mohan, *Agricultural Credit in India: Status, Issues and Future Agenda*, Reserve Bank of India Bulletin 2004,p.994, http:// rakeshmohan.com/docs/AgricreditBulletin.pdf (accessed May 18th , 2013)(Lecture delivered by Dr. Rakesh Mohan, the then Deputy Governor, Reserve Bank of India on February 5, 2004 at the 17th National Conference of Agricultural Marketing, Indian Society of Agricultural Marketing, Hyderabad

Rashid Amjad, *Key Challenges Facing Pakistan Agriculture: How Best Can Policy Makers Respond? A Not*e, https:// www.pide.org.pk/pdf/foodsecurity/research/FS1.pdf (accessed: 17th March, 2014).

Rashid Faruqee, *Strategic Reforms for Agricultural Growth in Pakistan*, Improving Rural Finance, World Bank Publications, 1999, p.123.

Randolph Barker, Claudia Ringler, Nguyen Minh Tien, Mark Rosegrant, *Macro Policies and Investment Priorities for Irrigated Agriculture in Vietnam, Comprehensive Assessment Research Report 6*, Comprehensive Assessment Secretariat, ISBN 92-9090-583-2,http://www.iwmi.cgiar.org/assessment/files_new/publications/.../CARR6.pdf(accessed: 29th March, 2014).

Rao Abdul Rauf Khan, *Farms Loans Recovery Problems in Pakistan: its Possible Solution*, The Pakistan Development Review, 33:4 Part 2 (Winter 1994),pp 837-843, http://pide.org.pk/pdr/index.php/pdr/article/view/1313/1286(accessed July 15th , 2014).

Renate K Loeppinger-T Odd And Manohar Sharma, *Innovations in Rural and Agriculture Finance*, J uly 2010, the International Food Policy Research Institute (IFPRI).

Report of the Committee on Rural Finance, State Bank of Pakistan, http://www.sbp.org.pk/report/contents.htm(accessed May 28th , 2014).

Reuben Jessop, Boubacar Diallo, Marjan Duursma, Abdallah Mallek, Job Harms, *Creating Access to Agricultural Finance Based on a Horizontal Study of Cambodia, Mali, Senegal, Tanzania,Thailand and Tunisia,* July 2012,p.24,

capacity4dev.ec.europa.eu/.../creating_access_to_agricultural_finance.pd(accessed July 16, 2013)

Rewa Misra, Primary *Agricultural Credit Society Linkage, India: The Best Remote Rural Self-Help Groups Can Do?* (Case Study), the Coady International Institute, June 2008.

Richard L. Meyer, *Subsidies as an Instrument in Agriculture Finance: A Review, Joint Discussion Paper* – Issue,German Federal Ministry Of Economic Cooperation And Development (Bmz), Food And Agriculture Organization Of The United Nations (Fao), German Agency For International Cooperation (Giz), International Fund For Agriculture Development (Ifad), The World Bank, And United Nations

Capital Development Fund (Uncdf), chapter 5, p.11.

Richard L. Meyer, *Microcredit and Agriculture: Challenges, Successes, and Prospects,* p.2 https://www.incofin.com/sites/.../Microfinance%20and%20agriculture.pd. (accessed October 17, 2013).

Ricardo Sánchez Serrano, *Ethical Issues Facing the Banking Industry*, Fidelis International Institute, January, 2010, https:// www.fidelisinstitute.org/article.php?se=13&ca=22(accessed: 20th March, 2014).

Robert C. Vogel and Donald W. Larson, *Limitations of Agricultural Credit Planning: The Case of Colombia* / Les Limites De La Planification Du Credit Agricole: Le Cas De La Colombie, Savings and Development, Giordano Dell-Amore Foundation ,vol. 4, no. 1 (1980), pp. 52-62.

Robin Burgess, Rohini Pande, *Do Rural Banks Matter?Evidence from the Indian Social Banking Experiment,* Discussion Paper No. DEDPS/40, August 2003, The Suntory Centre, Suntory and Toyota International Centre for Economic and Related Disciplines, London School of Economics and Political Science, http:// eprints.lse.ac.uk/.../Do_Rural_Banks_Matter_Evidence_from_the_Indian. (accessed: 23th March, 2014).

Rosalyn McKeown, *Education for Sustainable Development,* Introduction Section, http://www.esdtoolkit.org/discussion/default.htm (accessed: 10th August, 2014).

Ruxandra Berlinschi, Jo Swinnen ,Kristine Van Herck, *Subsidies and Agricultural Employment:The Education Channel*,(Selected Paper prepared for presentation at the International Association of Agricultural Economists *(IAAE) Triennial Conference*, Foz do Iguaçu, Brazil, 18-24 August, 2012), http:// ageconsearch.umn.edu/bitstream/126776/2/Berlinschi.pdf(accessed November 1st , 2013).

Sabir Mohamed Hassan, I*ssues in the Regulation of Islamic Banking(The Case of Sudan)*, Issue no.5,2004 ,Research and Studies Series Issued by Bank of Sudan,http://www.cbos.gov.sd/sites/default/files/issue_5.pdf - Cached(accessed August 30th,2014).

Saeed Yazdani, "*An Evaluation of Agricultural Credit System in Iran*", Giordano Dell-Amore Foundation, Savings and Development, 29/2 (2005); 117-132.

Saima Ayaz, Sof ia Anwar, Maqbool Hussain Sial, Zakir Hussain, *Role of Agricultural Credit on Production Efficiency of Farming Sector in Pakistan- A Data Envelopment Analysis*, Pakistan Journal of Life and Social Sciences, Pak. j. life soc. Sci. (2011), 9(1): 38-44.

Samuel Kwaku Obeng, *Rural Banking in Ghana: It's Impact on Rural Farmers (A Case Study of Abokobi Rural Area),* Samven's Research and Consultancy Unit, July, 2008 http://www.modernghana.com/ghanahome/download.asp?id=102(accessed October16, 2013).

Sara Saeed Khan, *Rural Finance Policy in Pakistan its Scope, Sources and Implications for the Microfinance Sector*, Pakistan Microfinance Network 2009,p.4 www.microfinanceconnect.inf, http:// (accessed March 3, 2013)

Shahid Hasan Siddiqui, *Accounting Article Instruments of Islamic Banking in Ope*ration, Published on 4/21/2008,http://www.accountancy.com.pk/articles. (accessed July 25,2009)

Shahidur R. Khandker,Rashidur R. Faruqee, *The Impact Of Farm Credit In Paki*stan , World Bank,p.2,http://www-wds.worldbank.org/.../IB/.../130530322_20041117174105.pdf (accessed June 30, 2013)

Shankariah Chamala and Shah M. Alamgir Hossain, *Adoption of Formal Agricultural Credit by Opinion Leaders and other Farmers in Differentially Developed Villages of Bangladesh,* Savings and Development, Vol. 20, No. 4 (1996), pp. 431-445.

Sharmini De Alwis, B. M. R. Basnayake, *Credit Guarantee Schemes in Sri Lanka --Way Forward,*第13期, pp. 51-82 **,** http://www.smeg.org.tw/doc/JSD-14-3.pdf(accessed: 29th March, 2014).

Shawkānī*, Nayl al-Awtār,* Dār Ehiā al-Tourath al-ʿArabī, 1st Edition.(2001).

S.Husain Ashraf , Mr. Ali Alizadeh Giashi, *Islamic Banking in Iran -Progress and challenge*s, Kuwait Chapter of Arabian Journal of Business and Management Review vol. 1, no.2; October 2011.

Sisay Yehuala, *Determinants of Smallholder Farmers Access to Formal Credit: The Case of Metema Woreda*, *North Gondar, Ethiopia*, (M.Sc. Thesis), April, 2008 Haramaya University, Department of Rural Developmen and Agricultural Extension School of Graduate Studies http://cgspace.cgiar.org/bitstream/handle/.../Thesis_YehualaDeterminants.pdf? (accessed October, 2013).

Smallholder Farming in Transforming Economies of Asia and the Pacific: Challenges and Opportunities, Discussion Paper prepared for the side event organized during the Thirty-hird session of IFAD's Governing Council, 18 February 2009 http://www.ifad.org/events/gc/33/roundtables/pl/pi_bg_e.pdf(accessed July 21th , 2014).

S.Mahendra Dev, *Subsidies and Investments in Indian Agriculture, Issues and Perspectives*, RGICS Paper No.39 (New Delhi: Rajiv Gandhi Institute forContemporary Studies, 1997) [PDF Version: 2010]. http:// www.rgics.org/pdf1/wpo-39.pdf (accessed November 1st , 2013).

S. S. Hosseini, M. Khaledi, M. Ghorbani, and D. G. Brewin, *An Analysis of Transaction Costs of Obtaining Credits in Rural Iran,* J. Agr. Sci. Tech. (2012) vol. 14: 243-256.

Sogrorio L. Floro, *Technical Change and the Structure of Informal Credit Markets In Philippine Agriculture*, Journa/ of Philippine Development Number Twenty-Five, vol XIV, no. 2, 1987, http://serp-p.pids.gov.ph/serp-p/download.php?d=487(accessed June 23rd , 2014).

Sohail Jehangir Malik and Hina Nazli, *Rural Poverty and Credit Use: Evidence from Pakistan,* The Pakistan Development Review, vol. 38, no. 4, Papers and Proceedings PART II Fifteenth Annual General Meeting and Conference of the Pakistan Society of Development Economists Islamabad, November 5-8, 1999 (Winter 1999), pp. 699-716.

Study on Informal and Non-Formal Rural Financial Services Concern Universal, Final Report, June 2012, pp.8-9. http:// www.concern universal.org/.../_universal_malawi_study_on_inform... (accessed April 10, 2013)…..(This report was conducted by Kadale consultants in March and April 2012 .

Study on the State of Domestic Commerce in Pakistan, Study No.9, Real Estate In Pakistan, Ministry of Commerce Government of Pakistan, http://www.commerce.gov.pk/Downloads/Real_Estate_Study.pdf , (accessed: 26th July , 2014).

Strengthening Agricultural support Services for Small Farmers, Report of the APO Seminar on Strengthening Agricultural Support Services for Small Farmers held in Japan, 4-11 July 2001 (SEM-28-01), Asian Productivity Organization, 2004.

S. Tilakaratna, *Credit Schemes for the Rural Poor: Some Conclusions and Lessons from Practice*, Issues in Development,Discussion Paper 9, Development and Technical Cooperation Department

International Labour Office Geneva, International Labour Organization 1996, ISBN 92-2-110101-0,p.3

Susanne Johanna Väth and Michael Kirk, *Do Contract Farming and Property Rights Matter for Rural Development? Evidence from a large-scale investment in Ghana institute for Co-operation in Developing Countries*, University of Marburg, Am Plan 2, 35032 Marburg, Germany, https://www.uni marburg.de/fb02/makro/forschung/magkspapers/16-2014_vaeth.pdf(accessed: 26th July , 2014.

Tayyab Safdar, *Agricultural crisis in Pakistan*, Published in The Express Tribune, January 22nd, 2014. http://tribune.com.pk/story/661560/agricultural-crisis-in-pakistan/ (accessed July 21th , 2014).

Thierry Mahieux, Omer Zafar, and Mylène Kherallah "*Financing Smallholder Farmers and Rural Entrepreneurs through IFAD supported Operations in the Near East and North*

Africa", Paper presented at the IFAD Conference on New Directions for Smallholder Agriculture24-25 January, 2001.

Timothy A. Wise, *The Paradox of Agricultural Subsidies: Measurement Issues, Agricultural Dumping, and Policy Reform*, May 2004, Tufts University Medford MA 02155, USA, http://www.ase.tufts.edu/gdae/Pubs/wp/04-02AgSubsidies.pdf(accessed November 22, 2013).

The State Bank of Pakistan Act 1956, Chapter iii (Management),Section 8 (3) , http:// www.sbp.org.pk/about/sbpact/SBP_ACT_1956.pdf(accessed March 3, 2013).

The State Bank of Pakistan Order, 1948, State Bank of Pakistan,pp3,4http://www.sbp.org.pk/about/sbpact/sbpact1.htm(accessed:29th July , 2014).

Todd Benson, Stephen L. Kirama, Onesmo Selejio,*The Supply of Inorganic Fertilizers to Smallholder Farmers in Tanzania Evidence for Fertilizer Policy Development*, IFPRI Discussion Paper 01230 December 2012, International Food Policy Research Institute Development Strategy and Governance Division http:// www.ifpri.org/sites/default/files/publications/ifpridp01230.pdf (accessed November 18, 2013).

Tushar Pandey, *Contracting and Agricultural Finance for Small Holders- Hi-Tech Farming and a Case for Public Private Partnerships*, http:// www.ncap.res.in/contract_%20farming/.../13.1%20Tushar%20Pandey.p(accessed August 17, 2013).

Urooba Pervaiz, Dawood Jan, Muhammad Zafarullah Khan, Mahmood Iqbal,Rukhsana Javed, *Disbursement of Agricultural Loans, Constraints and its Future Policy Implication*, Sarhad J. Agric.vol.27, no.2.

Wahbah-al-Zuhaylī, Al-Fiqhu-al-islāmī –Wa-Adilatuhū, Nashr Ihsan, 3rd Edition, 2006.

Walter Schaefer – Kehnert and Jhon D.Von Piodike "*Agricultural credit policy in developing countries*", World Bank Re Print Series: Number 280, 1982.p.4,http://www-wds.worldbank.org/external/default/.../IW3P/.../multi_page.pdf (accessed December 25, 2012).

W. A. Lawal, I.Babdullahi, *Impact of Informal Agricultural Financing on Agricultural Production in the Rural Economy of Kwara State, Nigeria*, International Journal of Business and Social Science vol. 2, no. 19 [Special Issue -October2011]

Waqar Akram, Zakir Hussain, M.H. Sial, Ijaz Hussain, *Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab*, European Journal of Scientific Research, vol.23, no.2 (2008), pp.294-304.

WilliamF. Steel, David O. Andah, *Rural and Micro Finance Regulation in Ghana: Implications for Development and Performance of the Industry*, Africa Region, Working Paper Series no.49 June 2003.

Winfried Manig,*The Importance of the Informal Financial Market for Rural Development Financing in Developing Countries: The Example of Pakistan* , The Pakistan Development Review 35 : 3 (Autumn 1996) pp. 229—239.

Yūsuf Al Qardāwi, *Bay' al-Murābaha lil-Aamir bi-Shirā Kamā Tujrihi al-Masrif –al- Islamiyya:* Dirssa fi Daw al-Nusus wa-al-Qawāid al-Shariyya. (Cario:Martabat Wahba, 1987).

Y. V. Reddy, *Future of Rural Banking*, (Prof. G. Ram Reddy Third Endowment Lecture by Dr. Y.V.Reddy, Deputy Governor, Reserve Bank of India, at Potti Sreeramulu Telugu University Auditorium Public Gardens, Hyderabad, on December 4, 1999, p.48.

Zoé Druilhe and Jesús Barreiro-Hurlé, *Fertilizer subsidies in sub-Saharan Africa*,

ESA Working paper No. 12-04 July 2012, http:// www.fao.org/docrep/016/ap077e/ap077e.pdf, (accessed December 30, 2013).

Focused Group technique Method

Application of Islamic Financing Modes to Agricultural Sector in Pakistan:

An Analysis of *Shari'ah* and Regulatory issues

I am a registered PhD scholar in the faculty of Shariah& Law at International Islamic University Islamabad. The purpose of this focused group method is to collect primary data in order to analyze the satisfaction level of farmers the viability of proposed models for financing agriculture on the basis of various modes of Islamic finance like *Mushārakah, Diminishing Mushārakah, Musāqah,and Muzāra', Murābaha, Musāwamah, Salam, Istisnā'* and *Ijārah*. Data collected would be used solely for academic purpose and respondents are assured of confidentiality of information provided. It is pertinent to mention that your participation in this study is completely voluntary in nature and, therefore, please feel free to decline if you do not want to participate for any reason. Moreover, answer each question with frankness and honesty. I thank you in advance for your assistance and cooperation in this academic study.

Sincerely,

Lutfullah Saqib

PhD. Scholar

Email:lutsaqib@yahoo.com

A) Respondent Profile

Age: ______________

Gender: ___________

Area or Name of Village ____

Some Preliminary Information

Highest Formal Education Attained:

- No formal education ( )
- Primary level ( )
- Middle level ( )
- High school level ( )
- Intermediate level ( )
- Bachelors level ( )
- Vocational education ( )
- Other______________

Average Household Income in Rs:

- 15,000 and below ( )
- 15,000 to 30,000 ( )
- 30,000 to 50,000 ( )
- 50,000 to 100,000 ( )
- Above 100,000 ( )

Farm Size (in Acres):

- Less than 0.5 Acres ( )
- 0.5 to 1.0 Acres ( )
- More than 1.0 Acres ( )

Farm Tenure Status:

- Owner ( )
- Share Tenant ( )
- Lease Holder ( )
- Others_______

B) Questions Related to Islamic Finance

B-1) Questions Related to *Qard Hasan* Based Model

1. *Qard Hasan* is a free interest loan in Islam.

a)Yes _______ b) No_______

2. Do you expect that the bank can provide you interest free loan?

a)Yes _______ b) No_______

3. Will you use such amount to fulfill your agricultural requirements and not social?

a)Yes _______ b) No_______

4. Will you pay this amount within the given time?

a)Yes _________ b) No_______

5. Will be you willing to give some extra amount over the original amount by your own free will?

a)Yes __________ b) No_______

6. Will you put your savings with same bank?

a)Yes _________ b) No_______

7. Will you accept if the bank provides you some agricultural inputs rather than cash and you return the same or sell it as an agent of the bank?

a)Yes __________ b) No_______

B-2) Questions Related to *Mushārakah* Based Model

1. Do you require heavy agricultural machinery?

a)Yes __________ b) No_______

2. Can you purchase such machinery for your self?

a)Yes __________ b) No_______

3. If you and bank purchase this machinery collectively from the market, will you accept such arrangement?

a)Yes _______ b) No_______

4. Will you be willing to give rent for the bank's shares till you become the sole owner of machinery?

a)Yes _______ b) No_______

5. Will you be willing to purchase share of the bank in installments?

a)Yes ___________ b) No_______

6. Do you think that this arrangement would benefit your farm activities?

a)Yes _______ b) No_______

7. Do you accept *Muzār'ah* Based Models

a)Yes _______ b) No_______

B-3) Questions Related to *Murābahah* Based Model

1. Do you want to purchase agricultural machinery or purchase farm inputs (like seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers etc) from a bank if it can provide you a commodity or farm inputs of good quality?

   a)Yes _______ b) No_______

2. Would you like to pay the price of the commodity or farm inputs in installments rather once?

   a)Yes ________ b) No_______

3. Are you ready to pay to the bank higher price of the commodity or farm inputs as compared to its price in the local market due to the above reasons?

   a)Yes _______ b) No_______

4. Do you want to provide some securities to the bank against the price?

   a)Yes _______ b) No_______

5. Do you want to pay some amount to the bank on *Amanah* basis and authorize it to pay the same in case of your refusal to purchase the commodity or farm inputs or delay the payment of any installment?

   a)Yes _______ b) No_______

6. If the bank authorizes you to purchase the commodity or farm inputs from the market as its agent, would you be agree?

   a)Yes _______ b) No_______

7. Are you sure that this arrangement will benefit your agricultural activities and production?

a)Yes _______ b) No_______

8. Are you willing to pay earnest money?

a)Yes _______ b) No_______

B-4) Questions Related to *Salam* Based Model

1. Do you agree if the bank purchase from you the coming crop production and pay you the price in advance?

a)Yes __________ b) No_______

2. Is this arrangement beneficial and suitable for you?

a)Yes _______ b) No_______

3. Will you use this amount solely for agricultural purposes?

a)Yes _______ b) No_______

4. Will you become agree to sell the production on the behalf of the bank?

a)Yes _______ b) No_______

5. In case of failure, from where you will arrange production of the same quality and quantity as mentioned in the contract ?

a)Yes _______ b) No_______

6. Have you sufficient securities for handing over to the bank, making it sure that you will deliver the commodity on time?

a)Yes _______ b) No_______

B-5) Questions Related to *Istisnā‘* Based Model

1. Are you facing irrigation problems?

a)Yes __________ b) No_______

2. Is this arrangement beneficial and suitable for you?

a)Yes _______ b) No_______

3. Do you like to pay in installments?

a)Yes _______ b) No_______

4. Can you provide securities?

a) Yes _______ b) No________

5.Do you want to become agent of the bank ?

a)Yes _______ b) No________

B-6) Questions Related to *Ijārah* Based Model

1. Do you have the ability to purchase agricultural equipments and implements like trailers & threshers, power tiller, power & boom sprayers, plough, cultivators, riggers/drills, rotavators, driggers, by your self?
   a)Yes ____________ b) No________

2. Do you know that you can hire all these equipments and implements from the bank on easy installments?
   a)Yes ____________ b) No________

3. Do you know that you can also avail transport facility through this arrangement?
   a)Yes ____________ b) No________

4. Do you want to purchase the hired equipment at the end of Ijārah?

   a)Yes ___________ b) No________

5. Are you sure that this arrangement will benefit your agricultural activities and production?

   a)Yes ___________ b) No________